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# Department of Agriculture

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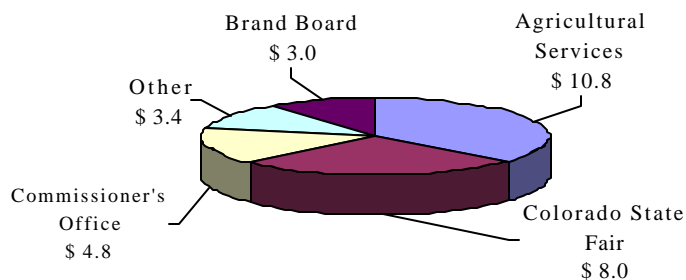
## Introduction

The Department of Agriculture is responsible for regulating, promoting, and supporting agricultural activities throughout Colorado. The Department performs services including policy formulation, data collection, program inspection, consumer information, and regulation of the State's agricultural industries. In addition, it manages the State Fair, whose audit is discussed in a separate report. The Department of Agriculture includes the following divisions:

- Commissioner's Office and Administrative Services
- Agricultural Services Division
- Agricultural Markets Division
- Brand Board
- Special Purpose
- Colorado State Fair
- Soil Conservation Board

The Department of Agriculture was appropriated \$30 million and 294 full-time equivalent staff (FTE) for Fiscal Year 2001. Approximately 34 percent of the funding is from general funds, 63 percent is from cash funds, and 3 percent is from federal funds.

**Department of Agriculture  
Fiscal Year 2001 Appropriations  
by Division  
(In Millions)**



**Source:** Joint Budget Committee Fiscal Year 2002 Appropriations Report.

## **Ensure Review of Payroll Information**

In Fiscal Year 2000 we recommended that the Department improve its review of employee personnel files and verify that withholding documentation is accurate and complete. The Department said it would require withholding information to be completed properly and to follow up on uncompleted forms. However, we found that this has not been done.

During our Fiscal Year 2001 audit, we reviewed a sample of 25 personnel files and found the following continuing problems with incomplete or missing information.

- Three instances where the marital status and/or the number of personal allowances to be taken on the W-4 (tax withholding) form did not agree with the information on the Colorado Payroll Personnel System. In two instances too much tax was being withheld and in another instance not enough tax was being withheld.
- Three W-4s were not properly completed. The marital status and/or the number of allowances were not completed for these three W-4s. However, the Department entered tax withholding information into the Colorado Payroll Personnel System for these W-4s.

These W-4s were completed prior to Calendar Year 1999. The Department is not adequately reviewing information contained in employee personnel files. This could adversely affect employees and/or the Department. If taxes are withheld at a different rate than indicated on the W-4, the employee may be paid the incorrect amount and may unexpectedly owe taxes.

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### **Recommendation No. 1:**

The Department of Agriculture should complete a review of employee personnel files and reconfirm that withholding documentation is accurate and complete.

### **Department of Agriculture Response:**

Agree. The Department of Agriculture Payroll office sent new W-4 forms to every employee to be properly updated, completed, and returned to the payroll office. New W-4 information was reviewed and entered into the Payroll

Personnel System. New W-4s were filed into each employee's personnel file in the Human Resources office.

Implemented December 2001.

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# Department of Corrections

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## Introduction

The Department of Corrections manages the State's adult correctional facilities and the adult parole system. The Department also operates the Prison Canteens and the Division of Correctional Industries. The Canteens provide various personal items for purchase by inmates, including toiletries, snack foods, and phone services. Correctional Industries operates furniture manufacturing facilities, computer manufacturing facilities, a leather products shop, a metal fabrication shop, a print shop, various farming and ranching facilities, Colorado State forms production and distribution facilities, an automotive service station, and the State's license plate manufacturing facility. It also manages the State's surplus property.

The Department's Fiscal Year 2001 operating budget was approximately \$482 million with 5,120 full-time equivalent staff (FTE). Administrative offices for the Department are located in Cañon City and Colorado Springs. Correctional facilities are located throughout the State and include Buena Vista, Cañon City, Denver, Pueblo, Limon, Ordway, Delta, Rifle, Golden, and Sterling.

The following comment was prepared by the public accounting firm of BKD, LLP, who performed audit work at the Department of Corrections.

## Improve Communication of Employee Status Changes Between Department Supervisors and the Payroll Department

During Fiscal Year 2001 the Department issued 66,208 paychecks for a total payroll of \$239,087,980. As part of that total, 225 manual checks were issued in the amount of \$343,147. Because of its large number of employees and associated payroll, the Department's payroll process is highly automated. Therefore, the communication of employee status changes from decentralized department supervisors is a critical factor in the centralized Payroll Department's ability to operate efficiently and effectively.

Department policy states that the department supervisors must notify the Payroll Department of employee status changes, such as a leave of absence, termination, or reinstatement, in a timely manner. The policy allows the Payroll Department to make changes to the employee's payroll records in the automated system to ensure that the employee is properly paid or not paid. If the Payroll Department is not notified of an employee status change, the employee could incorrectly receive a paycheck or the Payroll Department may have to issue the employee a manual check.

During our review of the Department's payroll procedures, we tested 28 individual paychecks, of which 3 were manual checks. For one paycheck selected for testing, we noted that the employee voluntarily terminated employment in November 2000, but the Payroll Department was not notified of the status change until December 2000. As a result, the employee was issued a manual check for \$3,273 in December. The employee subsequently returned the amount to the Department in March 2001.

The Department also prepares a monthly employee paycheck variance analysis as part of its internal controls related to payroll. The purpose of the analysis is to investigate changes in employee paycheck amounts from one month to the next and to detail the amount of the change and the reason for the variance. Use of the analysis allows the Department to identify errors in payroll processing and to test the reasonableness of monthly payroll expense.

As part of our testing, we selected 39 variances from February to March 2001 and reviewed the explanation of the variance for reasonableness. For one variance selected for testing, we noted the employee returned from medical leave in early March 2001, but the Payroll Department was not notified of the status change until after the March 2001 automated payroll was processed late in the month. As a result, the employee was issued a manual check for the amount of \$3,947.

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## **Recommendation No. 2:**

The Department of Corrections should review its policy on the communication of employee status changes with department supervisors to ensure that the communication is completed in a timely manner.

### **Department of Corrections Response:**

Agree. The Department of Corrections has an Administrative Regulation (AR 1450-08) that provides the policy that Appointing Authorities and individuals are

to comply with for processing voluntary and involuntary terminations from employment. The supervisor and Appointing Authority are required to complete a form for voluntary resignations and submit it to the Personnel Office. In the case of a dismissal, the Appointing Authority is to immediately notify Human Resources and Payroll prior to taking action.

Employees that return to work from illness or injury are to be reported by their supervisor or Appointing Authority to the Human Resources Office or Personnel Liaison. The Department provides training to supervisors and Appointing Authorities regarding Personnel rules and policies. The Department will increase its training effort with supervisors and Appointing Authorities regarding the importance of communicating status changes with the Payroll and Human Resources Offices.

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# Department of Health Care Policy and Financing

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## Introduction

The Department of Health Care Policy and Financing (HCPF) is the state agency responsible for developing financing plans and policy for publicly funded health care programs. The principal programs administered by HCPF include the Medicaid program, which provides health services to eligible needy persons, and the Children's Basic Health Plan (CBHP), which furnishes subsidized health insurance for children 18 years or younger in low-income families not eligible for Medicaid. The Medicaid grant is the largest federal program administered by the State and is funded approximately equally by federal funds and state general funds. CBHP was implemented in Fiscal Year 1998, and it serves as the State's version of the federal Children's Health Insurance Program. CBHP is funded by approximately two-thirds federal funds and one-third state funds. It is marketed as Child Health Plan Plus, or CHP+. During Fiscal Year 2001 the Department expended in total about \$2.3 billion and had 172 full-time equivalent (FTE) staff. In Fiscal Year 2000, HCPF expended \$2.09 billion and had 162 FTE.

The public accounting firm of BKD, LLP, performed the audit work at HCPF as of and for the fiscal year ending June 30, 2001. During its audit, BKD reviewed and tested HCPF's internal controls over financial reporting and federal programs. Also included was testing of the compliance with certain state and federal laws and regulations as required by generally accepted auditing standards, Governmental Auditing Standards, and U.S. Office of Management and Budget (OMB) Circular A-133.

## Reconcile Accounts Receivable

Currently, under the Medicaid program, the Department expends in excess of \$1 billion each in state general funds and in federal funds every year. Each time the Department records a qualifying expenditure for Medicaid, the State's accounting system automatically records a receivable from the federal government for the appropriate share of federal matching funds. In addition, at the end of each fiscal year, the Department records an estimate for Medicaid expenditures incurred but not submitted for payment prior to year-end. Each state agency is responsible for establishing adequate controls to ensure that all account balances reported on the State's financial system are accurate and complete. In

terms of accounts receivable balances, agencies are responsible for ensuring that all receivables are valid and reflect actual amounts owed to and collectible by the State. Further, agencies must ensure that amounts owed to the State are collected in a timely manner, and they must monitor year-end accruals to ensure appropriate adjustments are made for accruals that are over- or underestimated.

In Fiscal Year 1996 our audit report included a recommendation to the Department that the management of accounts receivable needed to be improved. Specifically, HCPF needed to complete timely reconciliations of these accounts and automate aspects of the reconciliation process. Subsequent audit reports noted that the Department had made some improvements in managing accounts receivable; however, this recommendation was not assessed as fully implemented because HCPF had not established timely and complete reconciliation procedures for its largest receivable—the federal receivable under the Medicaid program.

In Fiscal Year 2001 we found that the Department had established adequate procedures to reconcile the federal receivable account for Fiscal Years 1999, 2000, and 2001. In the process of performing these reconciliations, the Department concluded that there was approximately \$15.9 million still on the State's financial records as part of the federal receivable under Medicaid that had been recorded prior to Fiscal Year 1999 but which had not been collected. Additionally, although HCPF staff performed analysis of accounting records from prior years, they were unable to identify the entries—either actual expenditures, year-end accruals based on estimates, or some combination—that created the various amounts giving rise to the \$15.9 million. In any case, all amounts comprising the \$15.9 million are in excess of two years old. Therefore, they are not collectible from the federal government, because they exceed the two-year limit under federal Medicaid regulations for submitting expenditures and receiving federal matching funds. As a result, the State was required under generally accepted accounting principles to write off the \$15.9 million overstatement in accounts receivable on the Fiscal Year 2001 financial statements.

The occurrence of such a substantial write-off for an amount previously reported as a valid receivable is a reflection of the Department's lack of adequate controls in prior years. This instance also underscores the critical importance of establishing systematic controls over receivables, including regular monitoring and periodic, routine reconciliation of all accounts receivable balances. This is especially important for the Medicaid program due to the large volume of expenditures.



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### **Recommendation No. 3:**

The Department of Health Care Policy and Financing should ensure all accounts receivable balances are routinely reconciled on a periodic basis to expenditures and collections by grant period and by individual grant. Further, the Department should review its practices for determining the validity of federal accounts receivable, and all federal receivables not subsequently collected should be resolved within one year.

### **Department of Health Care Policy and Financing Response:**

Agree. As noted by the auditors, the Department has already designed and implemented adequate accounting procedures to ensure the full reconciliation of all accounts receivable balances and is ensuring the validity of the balances recorded on a timely basis. It is through these procedures that the Department discovered the \$15.9 million error. The Department conducted extensive research to determine the cause. While the actual cause was never determined, the Department was able to prove that the balance was recorded in error and did not represent a true receivable from the federal government. In addition, the Department is fully satisfied that the error is at least three years old and that it likely predates the formation of the Department in July of 1994. The Department believes that the most likely cause of the error is accounting practices that overstated federal receivables during a time when the federal match rate for the Medicaid program was declining each federal fiscal year, which begins on October 1 of each calendar year. The Department has requested that the State Controller's Office adjust the State's beginning fund balance in State Fiscal Year 2001 to correct this accounting error.

### ***Auditor's Addendum:***

*With regard to the Department's statement that the \$15.9 million was recorded in error and did not represent a true receivable, it is equally likely that the amount was originally a valid receivable and was not collected in a timely manner. Because the Department was unable to identify the specific grant period(s) and entries related to the \$15.9 million, we are unable to determine whether this is simply a bookkeeping error or a failure to collect monies owed to the State.*

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## Medicaid Funds Expended for Department of Human Services Programs

In January 2001 the Joint Budget Committee (JBC) reviewed a supplemental budget request from the Department of Human Services to address Medicaid overexpenditures totaling approximately \$10.6 million in Fiscal Years 2000 and 1999. In the course of reviewing the request, the JBC became concerned about the management and control of Medicaid funds that are used for Department of Human Services programs. This audit reviews the overexpenditure and the controls that the Departments of Human Services and Health Care Policy and Financing have established to ensure that expenditures are recorded and reported accurately.

The Department of Human Services (DHS) provides medical and mental health services to Medicaid-eligible individuals. Some of the services provided and individuals served are, among others:

- Mental health services for the mentally ill.
- Medical and health-related services for developmentally disabled individuals.
- Medical and mental health services for needy children who are served through Child Placement Agencies.

The Department of Human Services manages the mental health and medical services programs above. The Department of Health Care Policy and Financing (HCPF) administers the Medicaid program in Colorado. For Human Services programs, the Department of Health Care Policy and Financing makes Medicaid payments to providers directly, as reimbursement to Human Services for Medicaid-eligible expenditures, and as a pass-through of Medicaid funds through DHS to Colorado counties.

During Fiscal Year 2001 the Office of the State Auditor conducted a financial review of an overexpenditure of Medicaid funds at Human Services. The comments below were contained in the *Department of Human Services, Overexpenditure of Medicaid Funds Financial Review*, Report No. 1400, dated May 2001. The financial review contains comments directed at the Departments of Health Care Policy and Financing and Human Services; most of the comments are joint recommendations. The Department of Health Care Policy and Financing is the state agency that administers the Medicaid program. Therefore, for the purpose of this report, all six comments are listed collectively within this chapter located on the next ten pages.

## Responsibilities Need to Be Clarified

During our review it became apparent that there is little accountability for expenditures of Medicaid funds related to mental health services and health-related services for, among others, developmentally disabled individuals and children in foster homes. We found little evidence that accounts had been reviewed, amounts reconciled, and expenditure trends evaluated. For example:

- C Because Department of Human Services staff did not adequately review Medicaid expenditures, staff did not determine until November 2000 that over \$3 million of Fiscal Year 1999 Medicaid activity was coded against the Fiscal Year 2000 appropriation. This contributed to the \$10.6 million overexpenditure. The Departments, therefore, did not adhere to State Fiscal Rules requiring them to identify the overexpenditure timely and notify the State Controller's Office of the overexpenditure.
- C Health Care Policy and Financing staff do not routinely review activity posted to their Medicaid transfer appropriation. Staff indicate they are only recording expenditures resulting from Human Services program activity, so they do not have the knowledge to determine if transactions posted to the appropriation are appropriate.

Currently the Department of Health Care Policy and Financing pays the bills, ensuring that expenditures are proper and eligible for federal Medicaid reimbursement. The Department of Human Services sees its role as administering various Medicaid-funded programs, such as mental health capitation and services for developmentally disabled individuals. It is evident that neither Department has assumed responsibility for managing and controlling costs for Medicaid-funded programs. Neither Department has reviewed expenditure trends or analyzed data to identify coding problems or possible overexpenditures. The \$10.6 million overexpenditure resulted in part from this lack of accountability.

Lack of accountability is of great concern. The State spent over \$466 million in general, federal Medicaid, and cash funds on these programs in Fiscal Year 2000. The State needs accurate information on expenditures in order to forecast budgets, develop rates, and control costs. Also, statutes clearly state that agencies are not to expend funds without legal authorization and outline specific steps to be taken to obtain approval from the State Controller and Governor for such expenditures. We believe that the Departments must work together to ensure that expenditures for Human Services Medicaid-funded programs are appropriately managed and that the two Departments are in compliance with budgetary and statutory requirements.

**Recommendation No. 4:**

The Department of Human Services and the Department of Health Care Policy and Financing should work together to assign responsibilities for overall cost control over Medicaid funding for Department of Human Services programs.

**Department of Human Services Response:**

Agree. The Colorado Department of Human Services recognizes and concurs with the need for increased accountability over Medicaid funding for programs administered by the Department. On April 24, 2001, the two Departments met to begin the process of assigning duties and responsibilities to achieve accountability. We anticipate an implementation date of December 31, 2001.

**Department of Health Care Policy and Financing Response:**

Agree. The Department of Health Care Policy and Financing is firmly committed to working with the Department of Human Services to ensure that all responsibilities for Medicaid-funded programs are clearly and completely delineated between the two departments. On February 1, 2001, in an email from the Department of Health Care Policy and Financing's Acting Executive Director, the Department of Health Care Policy and Financing asserted its intention to build quarterly reconciliation and monitoring protocols, and to build and implement fiscal closeout procedures. The new Long Bill format for Fiscal Year 2002 should assist us in this effort. We plan to have an implementation date of December 31, 2001.

**Recommendation No. 5:**

The Department of Human Services and the Department of Health Care Policy and Financing should follow State Fiscal Rules and statutes concerning expenditures by operating within their fixed budgets when possible, and identifying and requesting approval for all unavoidable overexpenditures in a timely manner.

### **Department of Human Services Response:**

Agree. DHS will follow State Fiscal Rules and statutes concerning expenditures by operating within fixed budgets, when possible, considering the nature of the entitlement program, and requesting approval for unavoidable overexpenditures in a timely manner. This process will occur in tandem with the Department of Health Care Policy and Financing's analysis of information relevant to expenditures, projections, and budget supplemental requests. This recommendation will be implemented for the close of State Fiscal Year 2001 at June 30, 2001, by August 6, 2001.

### **Department of Health Care Policy and Financing Response:**

Agree. The Department of Health Care Policy and Financing will ensure that it complies with State Fiscal Rules and report any overexpenditure to the State Controller in a timely manner. This recommendation will be implemented for the close of State Fiscal Year 2001 at June 30, 2001, by August 6, 2001.

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## **Coordination and Communication Need to Be Improved**

We found that there is a lack of coordination and communication between the two Departments with respect to the management of Medicaid funds for Department of Human Services programs. Specifically, staff are not coordinating efforts or communicating essential information related to expenditures charged to the appropriation to ensure that the Medicaid expenditures are appropriate. As a result, problems exist. Two examples are summarized below:

#### ***Mental Health Capitation Fee-for-Service Costs***

The Department of Health Care Policy and Financing staff did not consistently record expenditures for mental health services provided on a fee-for-service basis. We found that staff charged about \$2.6 million in estimated fee-for-service expenditures to the Medicaid capitation organizational code within the Medicaid transfer appropriation in July 2000. However, Fiscal Year 1999 fee-for-service expenditures were charged to the Department of Health Care Policy and Financing and were never transferred to Human Services. In addition, the Fiscal Year 2000 fee-for-service expenditures were charged to Human Services in one lump sum at the end of the fiscal year. The Department of Health Care

Policy and Financing staff indicated that they were unable to determine the amount of the costs that should be transferred to Human Services for Fiscal Year 1999 due to the change in Medicaid fiscal agents and the implementation of the new Medicaid Management Information System (MMIS) in December 1998. We also noted that because of a total breakdown in communication between and within the departments, Human Services program and accounting staff were not notified of the Fiscal Year 2000 fee-for-service charge. Human Services staff indicated that they did not budget for these costs because Health Care Policy and Financing staff had not charged the costs to the appropriation in the past. In part as a result of these costs, the mental health capitation portion of the appropriation was overexpended.

#### ***Accounts Payable Accrual***

Once the Fiscal Year 1999 accounts payable accrual for the Medicaid cash exempt funds was exhausted, Health Care Policy and Financing staff changed the interface between the Medicaid Management Information System (MMIS) and COFRS (the State's accounting system) to shift \$3.2 million of remaining Fiscal Year 1999 expenditures to the Fiscal Year 2000 appropriation. Health Care Policy and Financing staff did not differentiate these expenditures in COFRS from other Fiscal Year 2000 expenditures so that they could be properly reclassified as prior year activity.

Properly differentiating expenditures is important for both budgeting and rate-setting purposes. Erroneous baseline data will result in forecasting errors and may result in subsequent year overexpenditures. As noted, the \$3.2 million of Fiscal Year 1999 activity coded to Fiscal Year 2000 resulted in a Fiscal Year 2000 overexpenditure. In addition, generally accepted accounting principles require expenditures to be coded to the year in which they were incurred. We noted that, again, due to a breakdown in communication between and within the departments, Human Services program and accounting staff were not notified of the switch to add prior year expenditures to the Fiscal Year 2000 appropriation.

Health Care Policy and Financing staff indicated that, beginning in Fiscal Year 2001, they have implemented account coding changes so prior year activity charged to the current year appropriation is differentiated from current year activity. However, staff from both Departments indicate that they have not established policies for charging costs to the Medicaid transfer appropriation or agreed on procedures to be followed when accounts payable accruals are exhausted and prior year activity remains. The two Departments need to work together to establish protocols such as instituting quarterly transfers of expenditures and documenting policies and procedures for charging expenditures so that problems can be avoided in the future.

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## **Recommendation No. 6:**

The Department of Human Services and the Department of Health Care Policy and Financing should work together to improve coordination and communication relating to expenditures for Department of Human Services Medicaid-funded programs to ensure that expenditures are appropriately and consistently charged and that expenditures are transferred timely. This should include establishing and documenting policies and procedures for charging Medicaid expenditures for Department of Human Services programs.

### **Department of Human Services Response:**

Agree. It is recognized that development and documentation of policies and procedures for charging Medicaid expenditures for Department of Human Services programs will assist in the coordination and communication relating to expenditures for Medicaid-funded programs within DHS. DHS will cooperate with DHCPF to ensure formal communication occurs regularly, timely, and accurately to the appropriate Department personnel. DHS will initiate this recommendation in Fiscal Year 2002, with outlines available by December 31, 2001.

### **Department of Health Care Policy and Financing Response:**

Agree. We will fully cooperate with DHS staff to ensure that all expenditures are properly charged in a manner that allows them to monitor the cost of their programs. We have always informally notified Human Services staff of the status of their payable accounts; we will ensure that all interaction is formal and in writing in the future. We will also work with DHS staff to ensure they have the tools that they need to perform detailed monitoring of expenditures and activity. Implementation of this recommendation is scheduled for December 31, 2001.

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## Comprehensive Reconciliation and Review Procedures Are Needed

We found that neither the Department of Human Services nor the Department of Health Care Policy and Financing is performing critical reconciliations. For example, we found that Human Services Health and Rehabilitation staff do not reconcile all amounts charged to the Health Care Policy and Financing capitation organizational code to supporting documentation to determine that expenditures are appropriate or to anticipate and identify overexpenditures. While Health and Rehabilitation staff reconcile Medicaid Management Information System (MMIS) and COFRS information for Mental Health Assessment and Service Agency (MHASA) payments on a monthly basis, no one reconciles other activity posted to the capitation organizational code to supporting documentation. We also found that mental health institute staff did not analyze about \$250,000 of the overexpenditure attributed to their program.

This lack of review is problematic in part because errors may not be detected or detected timely. We found several coding errors that were not detected timely by staff within either department. Specifically:

- C Nearly \$116,000 in provider payments were erroneously charged to the mental health institute organizational code by the Department of Health Care Policy and Financing in Fiscal Year 2000. About \$30,000 of the payments was attributed to Fiscal Year 1999 activity. Department of Human Services staff did not identify the error until January 2001 when they were analyzing the overexpenditure. No entry was made to reclassify the expenditures to the proper organizational code because neither department reviewed the provider payments to determine where they should have been charged.
- C Health Care Policy and Financing staff erroneously charged all mental health institute Medicaid activity to a nontransfer appropriation during the first six months of Fiscal Year 2000. They did not identify the error and correct the problem until January 2000. Human Services staff did not realize this error had occurred until they were reviewing Fiscal Year 2000 activity in January 2001.
- C The \$2.6 million in estimated fee-for-service costs charged to the transfer appropriation for Fiscal Year 2000 was \$690,000, or 36 percent, higher than actual fee-for-service costs, due in part to a Health Care Policy and Financing staff compilation error. Staff determined only after receiving an inquiry from DHS staff in January 2001 that an error existed in the methodology used for the calculation.



We also found that Human Services staff did not determine until the end of Calendar Year 2000 that they did not make appropriate expenditure and accounts payable estimates at the end of Fiscal Year 1999 for all Medicaid-funded programs, or provide the information to Health Care Policy and Financing staff. Prior to Fiscal Year 2001, Health Care Policy and Financing staff coded all Human Services Medicaid expenditures to one accounts payable account. As a result, Medicaid payments made in Fiscal Year 2000 for Fiscal Year 1999 activity for some Human Services programs were coded against accounts payable accruals established for other programs. This caused some programs to appear to be overexpended for Fiscal Year 2000 when they may not have been.

When analyzing information related to the overexpenditure, Human Services staff also found additional errors within the following program areas that had not been identified previously:

***Child Welfare/Child Placement Agencies***

The \$2.5 million overexpenditure attributed to Child Welfare/Child Placement Agencies was due to two Human Services staff errors concerning the Child Placement Agency transfer program. Although this program is intended to have no General Fund impact, since it only involves a transfer of general funds, the two errors resulted in a \$1.26 million General Fund overexpenditure for the program.

***County Administration***

The federal portion of the County Administration share of the appropriation was overstated by \$994,360 due to a booking error made by Health Care Policy and Financing staff. The error occurred when staff were booking General Fund transfers from Human Services to Health Care Policy and Financing at the end of the fiscal year, as authorized by statute. Due to an offsetting \$17,393 County Administration overexpenditure, the net underexpenditure equaled \$976,967.

***Children, Youth, and Families***

The \$101,000 overexpenditure of the Children, Youth, and Families portion of the appropriation was due to House Bill 99-1116 expenditures that were erroneously charged to the Medicaid transfer appropriation. This bill established a program to provide mental health services for children who are not categorically eligible for Medicaid. Prior to Fiscal Year 2002 no amount was included in the Medicaid transfer appropriation for this program.

## **The Departments Need to Monitor Expenditures and Establish Procedures Over Medicaid Appropriations**

The lack of review over Medicaid expenditures for Human Services programs is troubling for several reasons. First, Medicaid expenditure errors have serious budget implications for the State due to TABOR limits because Medicaid has a great impact on the demand for general funds. Specifically, the Medicaid program requires a 50 percent General Fund match.

In addition, the State lacks accurate information for rate-setting in the mental health managed care program. Since the Department of Human Services does not have a comprehensive review process over the expenditures charged to the mental health capitation system, it cannot be sure that rates are appropriate.

Finally, Department of Human Services staff lack necessary information to determine which programs are overexpending their portion of the appropriation. This is important because while some of the programs are entitlement programs and, therefore, may under- or overexpend their appropriation, other programs are expected to fully operate within their budgets.

It is, therefore, essential for both Departments to implement stronger controls. This should include establishing ongoing, comprehensive reconciliation processes between the two Departments and within the Department of Human Services programs. This will assist department staff with identifying errors and potential overexpenditures. Department of Human Services staff should also implement an analytical review process over Medicaid cash exempt expenditures so that they can identify areas where costs may be contained. Finally, Human Services staff must also ensure that, in future years, they appropriately estimate and accrue accounts payable as required by State Fiscal Rules and generally accepted accounting principles.

By making these improvements, the Departments can help ensure that Medicaid expenditures for Human Services programs are appropriate, Human Services has accurate information for budgetary and planning purposes, and the State's financial statements appropriately reflect the amount and nature of financial transactions and balances.

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**Recommendation No. 7:**

The Department of Human Services and the Department of Health Care Policy and Financing should institute a formal, quarterly process for reviewing and reconciling Medicaid expenditures for Department of Human Services programs recorded at the Department of Health Care Policy and Financing. This reconciliation should be documented and approved by the Departments' controllers.

**Department of Human Services Response:**

Agree. DHS will institute a quarterly reconciliation process that will be documented and approved by the Departments' controllers. Implementation of this recommendation is scheduled for close of period 6 of State Fiscal Year 2002 at December 31, 2001, and the reconciliation process will be completed by January 31, 2002.

**Department of Health Care Policy and Financing Response:**

Agree. The Department of Health Care Policy and Financing is firmly committed to working with the Department of Human Services to ensure that formal quarterly review and reconciliation of DHS Medicaid expenditures occurs and is properly approved. Implementation of this recommendation is scheduled for close of period 6 of State Fiscal Year 2002 at December 31, 2001, and the reconciliation process will be completed by January 31, 2002.

**Recommendation No. 8:**

The Department of Human Services should improve its management of Medicaid funds by:

- a. Establishing monthly reconciliation processes to be followed by management and staff within Medicaid-funded programs and communicating problems timely to Department of Health Care Policy and Financing staff.
- b. Implementing an analytical review process over Medicaid activity so that possible areas for cost containment are identified.

### **Department of Human Services Response:**

Agree. The reconciliation and review process will occur on a monthly basis. The processes for accomplishing this task are anticipated to begin during Fiscal Year 2002 and to be established on a regular basis second quarter Fiscal Year 2002 close. The reconciliation process will include analytical review, which will assist in the mitigation of unforeseen overexpenditure. Implementation date: January 31, 2002.

### **Recommendation No. 9:**

The Department of Human Services should follow generally accepted accounting principles related to accounts payable by:

- a. Calculating appropriate year-end estimates for remaining Medicaid-funded program activity for all department programs and communicating this information to the Department of Health Care Policy and Financing.
- b. Reviewing expenditures charged to accounts payable after year-end to determine that expenditures are charged to the appropriate fiscal year.

### **Department of Human Services Response:**

Agree. The 1999 fiscal year-end accounts payable accrual did not contain an estimate for the Mental Health Capitation program. DHS will implement internal controls to ensure that accounts payable are properly recorded and accounted for in accordance with generally accepted accounting principles. Analytical review will determine the point in time that additional spending authority may be necessary. Implementation date: August 6, 2001.

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# Department of Higher Education

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## Introduction

The Department of Higher Education was established under Section 24-1-114, C.R.S., and includes all public higher education institutions in the State. It also includes the Auraria Higher Education Center, the Colorado Commission on Higher Education, the Colorado Council on the Arts, the Colorado Student Loan Division, the Colorado Student Obligation Bond Authority, the Colorado Historical Society, and the Division of Private Occupational Schools.

State public institutions of higher education are governed by six different boards. The governing boards and the schools they oversee are:

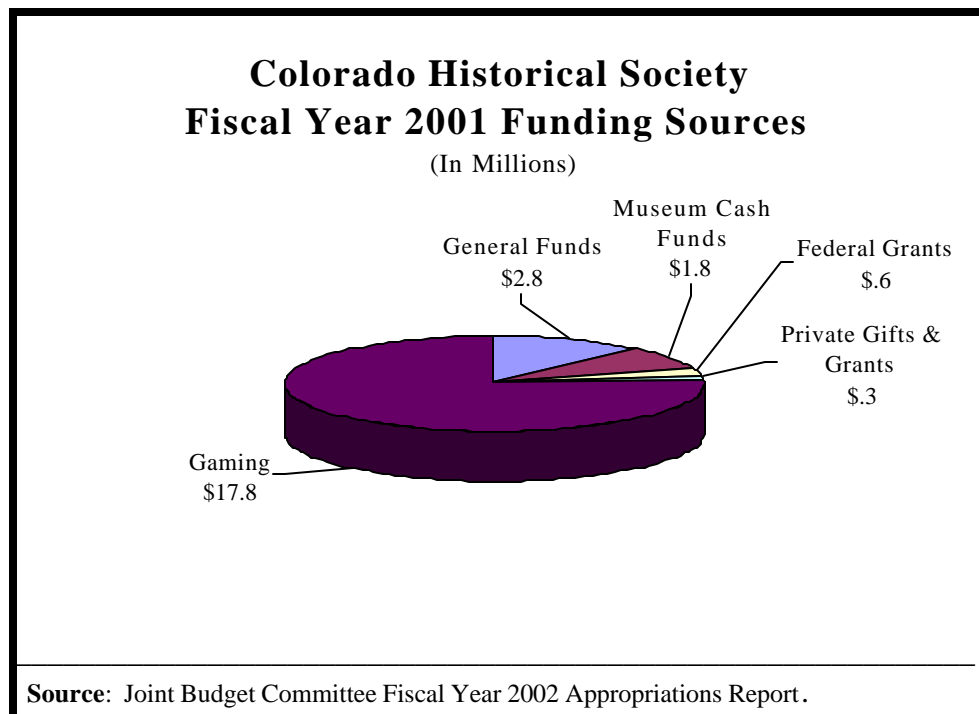
- **Board of Regents of the University of Colorado**  
University of Colorado at Boulder  
University of Colorado at Colorado Springs  
University of Colorado at Denver  
Health Sciences Center
- **State Board of Agriculture - Colorado State University System**  
Colorado State University  
Fort Lewis College  
University of Southern Colorado
- **Trustees of the State Colleges of Colorado**  
Adams State College  
Mesa State College  
Metropolitan State College of Denver  
Western State College  
Western Colorado Graduate Center
- **State Board for Community Colleges and Occupational Education (SBCCOE)**  
14 Community Colleges

- **Trustees of the University of Northern Colorado**  
University of Northern Colorado
- **Trustees of the Colorado School of Mines**  
Colorado School of Mines

## Colorado Historical Society

The Colorado Historical Society, founded in 1879, has statutory designation as an educational institution of the State. It has exclusive control over the State's historical monuments and in this capacity has the duty to survey suitable sites and structures for historical designation by the State. The Society is charged with administration of a state register of historic properties.

The Colorado Historical Society was appropriated \$23.3 million and 106.1 full-time equivalent staff (FTE) for Fiscal Year 2001. Approximately 76 percent of the funding is from Gaming revenue.



## **Improve Controls Over Cash Receipts**

In Fiscal Year 2000 we recommended that the Colorado Historical Society require all museums to submit cash register tapes with revenue remittances to the Administrative Services Section. This provides an independent verification that the cash remitted agrees to the sales reported on the cash register tapes. The Colorado Historical Society updated its policies, but we continue to find problems.

During our Fiscal Year 2001 audit, we reviewed a sample of 22 deposits totaling about \$15,000. We found six deposits totaling about \$2,300 in which a museum, the Byers-Evans House, did not submit a cash register tape with its revenue remittance. As such, the Society cannot ensure that all remittances were submitted for deposit. The cash register tape would also provide support for types of sales, voids, and over- or underages that could assist the Society in evaluating the activities at the Byers-Evans House.

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### **Recommendation No. 10:**

The Colorado Historical Society should ensure the Byers-Evans House submits cash register tapes with all revenue remittances.

### **Colorado Historical Society Response:**

Agree. The Byers-Evans House cash transmittals had been submitted in the past without cash register tapes. The need for cash register tapes with each cash transmittal was communicated to the director of the house, but apparently did not reach all staff. This has since been corrected, and all cash transmittals from the house since December 31, 2001 include cash register tapes.

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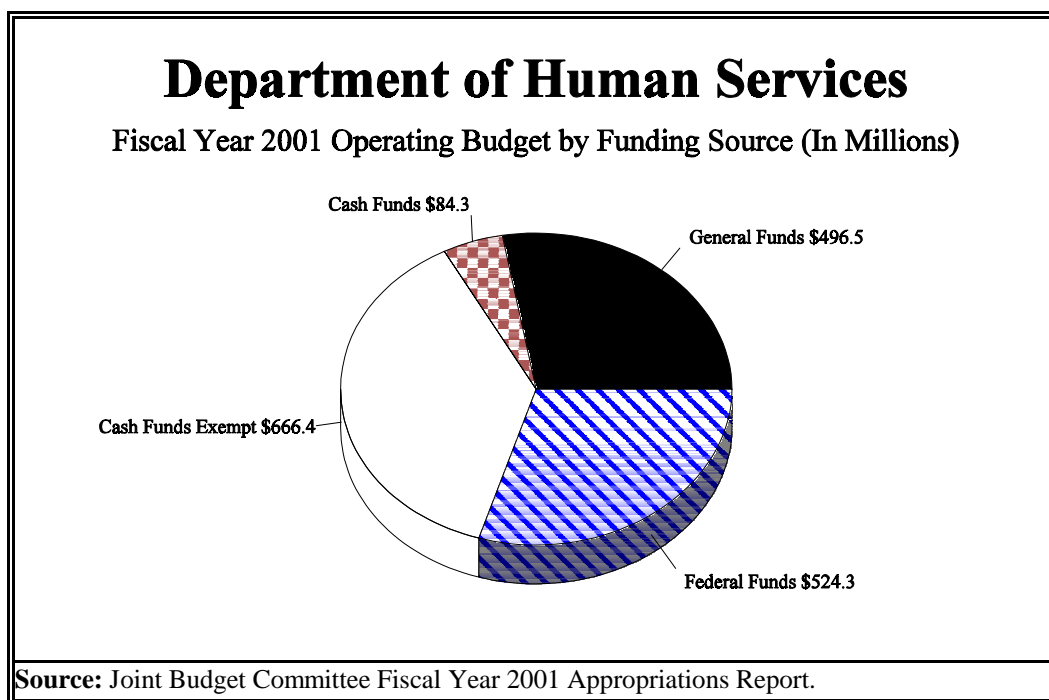
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# Department of Human Services

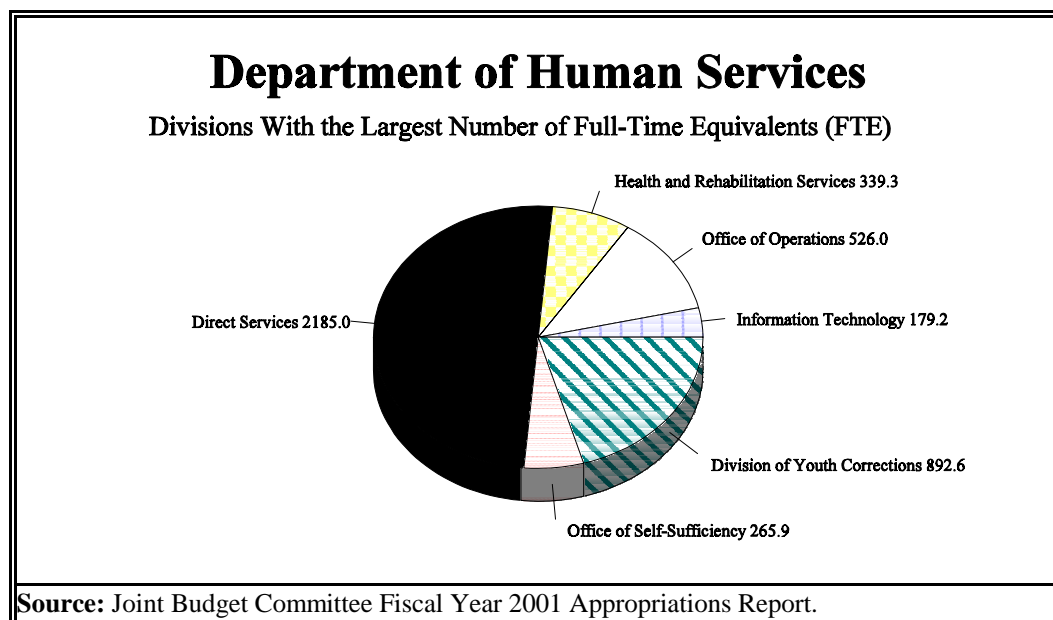
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## Introduction

The Department of Human Services is solely responsible, by statute, for administering, managing, and overseeing the delivery of the State's public assistance and welfare programs throughout the State. Most of these programs are administered through local county or district departments of social services. The Department also manages programs in the areas of mental health, rehabilitation, youth corrections, and developmental disabilities. In Fiscal Year 2001 the Department expended approximately \$1.8 billion and had 4,682.8 full-time equivalents (FTE). The following charts show the operating budget by funding source and the divisions/offices with the largest FTE, respectively, for Fiscal Year 2001:







We reviewed and tested the Department's internal accounting and administrative controls and evaluated its compliance with state and federal rules and regulations. Generally, we found that the Department has adequate administrative and internal controls to oversee its operations and meet state and federal requirements. We identified ten areas where improvements could assist the Department in effectively managing its responsibilities—three related to financial statement issues and seven related to federal awards.

## Adhere to Legally Established Spending Limits

The Office of Operations within the Department of Human Services is responsible for providing centralized departmental functions including accounting, contracting, purchasing, and facility management. In Fiscal Year 2001 the Office of Operations was appropriated approximately \$23 million for payment of salaries and wages for the 526 FTE within the Office.

At the end of each fiscal year the Office's Division of Accounting estimates and records accounts payable for current year expenditures that will be paid in the following fiscal year. All departmental expenditures, including estimates for expenditures yet to be paid, are charged against specific appropriation codes. Appropriation codes are set up in the State's accounting system to track each agency's

utilization of its legally established spending authority under the State's annual appropriation law.

When actual payments for the accrued amounts are made in the subsequent fiscal year, the payments are charged against the appropriate accounts payable. After all payments related to the accrual have been made, any excess amount in accounts payable must be reversed by crediting the revenue source used to establish the payable.

## **Accounts Payable Accrual Was Used for Unrelated Payments**

During our audit we found that in Fiscal Year 2001 the Division of Accounting charged \$77,562 in personal services payments for that year against an unspent accounts payable established at the end of Fiscal Year 2000 for a different appropriation code and purpose. The personal services payments were for payouts of sick and annual leave to staff retiring from the State in Fiscal Year 2001. Under state regulations, the Department should have charged the payouts to the personal services appropriation and reversed the unused accounts payable.

The Department's use of an unrelated accounts payable accrual to fund personal services expenditures is a serious concern. This type of transaction circumvents controls established by the appropriations process over agencies' spending authority and, in some instances, can be used to hide overexpenditures.

In this particular case, if the Department had charged the personal services payments to the correct appropriation code, the Department states it would then have reduced its accrual at the end of Fiscal Year 2001 for anticipated Fiscal Year 2002 retirement payments by \$77,562 in order to avoid an overexpenditure. Under an accounting directive issued by the Office of the State Controller, the Department is allowed to charge Fiscal Year 2002 retirement payouts to its Fiscal Year 2001 appropriation if employees have given formal notice during the current year that they will retire in the subsequent year. If the Department had decreased this accrual at the end of Fiscal Year 2001, it would have shifted \$77,562 in payouts to the personal services appropriation for Fiscal Year 2002. Thus, the Department does not believe it would have overspent its Fiscal Year 2001 appropriation, had it recorded the payment correctly.

We agree that the Department could have recorded the \$77,562 payouts correctly and still avoided an overexpenditure. However, by recording this payout expenditure against an unrelated and unused accounts payable, the Department, in effect, increased its appropriation for personal services in Fiscal Year 2001 by \$77,562.

This was done by charging the \$77,562 in retirement payouts to the unrelated appropriation and overstating those expenditures for Fiscal Year 2000. Personal services expenditures for Fiscal Year 2001 are understated by the same amount.

Effective Fiscal Year 2002, under new accounting standards, state agencies will be required to record all retirement payouts in the year in which the individual's retirement occurs, as opposed to the year in which notice of retirement was received. This will require additional fiscal discipline by all state agencies. The Department should take additional steps to ensure that funds are spent in accordance with appropriations created by law. This should include reviewing entries made to the State's financial system on a regular basis for unusual activity, especially at the end of the fiscal year.

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### **Recommendation No. 11:**

The Department of Human Services should follow state regulations and statutes by recording expenditures within the proper appropriations and reversing unused accounts payable accruals.

#### **Department of Human Services Response:**

Agree. The Department acknowledges that there was an inappropriate use of accounts payable. The Department will reinforce through training of the procedures to review all outstanding payables and reversions as detailed in the accounting manual and in the monthly SCO diagnostic report overview.

Implementation Date: July 1, 2001

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## **Improve Controls Over Fixed Assets**

Each state agency is responsible for ensuring that all fixed assets purchased or constructed by the State are properly accounted for when acquired and disposed of, accurately inventoried, and safeguarded throughout their life. Fixed assets include items such as furniture, equipment, leasehold improvements, and buildings. In Fiscal Year 2001 the Department purchased or constructed about \$33.3 million in fixed assets. This amount does not include fixed assets purchased through the Department's proprietary or fiduciary activities.

During our Fiscal Year 1998 audit, we identified problems with the Department's controls over its fixed assets, specifically with regard to ensuring new assets were appropriately recorded on COFRS, the State's financial system, and subsequently tracked. Although the Department addressed several of our concerns during Fiscal Years 1999 and 2000, we continued to identify problems with the Department's fixed asset reconciliation process during our Fiscal Year 2001 audit.

## **Fiscal Year-End Reconciliations Were Not Completed Timely or Accurately**

State agencies ensure new fixed assets are properly recorded on COFRS by performing a reconciliation between fixed-asset expenditures and amounts recorded as additions to fixed assets on COFRS during the fiscal year. Department procedures require staff at each of the Department's 16 agencies to prepare fixed asset reconciliations between these two amounts on a quarterly basis and submit them to the Department's central agency. The central agency encompasses the Department's Executive Director's Office (EDO) and other central administrative functions, as well as the majority of the Department's social service programs. In Fiscal Year 2001, \$6.3 million of the Department's fixed asset purchases were made through this agency, which includes purchases made on behalf of the Department's other agencies.

We found that the Department did not reconcile fixed asset expenditures to additions for any of its 16 agencies prior to the year-end close of the State's financial records. While 12 of the 16 agencies submitted reconciliations to us in September, or 2 ½ months after the closing date for Fiscal Year 2001 entries, the remaining 4 agencies had not provided us with reconciliations by the end of our testwork. In addition, we noted that the Department had not completed a departmentwide reconciliation for Fiscal Year 2001. The departmentwide reconciliation must be performed after all agency reconciliations are complete to ensure all items transferred between agencies are appropriately recorded and tracked. For example, the central agency's reconciliation listed a transfer for over \$14,000 in fixed assets to another of the Department's agencies. However, the receiving agency had not submitted any reconciliations in Fiscal Year 2001, and as a result, the Department could not be certain that the agency had received these assets and recorded them.

## **Department Oversight of Fixed Asset Procedures Should Be Improved**

As mentioned earlier, the Department has had problems accurately tracking purchases of fixed assets in prior years. While we recognize that the size of the

Department and the disbursement of its activities throughout the State present difficulties, these factors also create a greater risk that assets could be lost or misappropriated. The Department needs to address the deficiencies in fixed asset reconciliations to ensure assets are safeguarded and the correct amounts are reflected on the State's financial records.

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### **Recommendation No. 12:**

The Department of Human Services should improve controls over fixed assets to ensure all fixed assets are safeguarded and appropriately recorded on COFRS by:

- a. Completing quarterly agency and department-wide reconciliations between fixed asset expenditures and additions to fixed assets.
- b. Correcting identified errors on COFRS prior to fiscal year-end.

### **Department of Human Services Response:**

- a. Agree. The Department has a procedure in place whereby these quarterly reconciliations are to be completed and turned into the central office for review and reconciliation. To ensure compliance with this procedure, the Department will establish follow-up procedures for when the quarterly reconciliations are not completed timely.
- b. Agree. The Department will perform a department-wide reconciliation that reconciles all individual agency reconciliations to each other and to the general ledger control account.

Implementation Date: March 31, 2002

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## **Securities in Lieu of Retainage Balance Not Reported Accurately**

As part of our audit of fixed assets, we reviewed retainages recorded on COFRS for construction projects. State regulations require agencies to retain a percentage of the total cost of the contract for all capital construction projects until the project is completed and formally accepted by the State. In lieu of holding a percentage of payments, a contractor may choose to place securities with a value equivalent to the

retainage percentage in the Department's name with a bank authorized by the Department.

We found that the Department does not have procedures in place to ensure that securities held in lieu of retainage amounts for construction projects are recorded into COFRS accurately and in a timely manner. We noted that the amount on COFRS at June 30, 2001, was understated by \$102,000 for one project. Due to an increase in the amount of that project during the fiscal year, the contractor was required to place additional securities in the Department's name. While Department Facilities Management staff were aware of the addition, these staff failed to notify the Department's central accounting staff of the change, and therefore, the increase was not reflected on COFRS.

By improving communication between agency and accounting staff regarding securities held as retainage for construction projects, the Department can help ensure that securities are accurately recorded and tracked.

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### **Recommendation No. 13:**

The Department of Human Services should develop and implement procedures to ensure securities held as retainage for construction projects are recorded in COFRS accurately and in a timely manner.

### **Department of Human Services Response:**

Agree. The Department will change existing procedures to have all bank statements sent to the Division of Accounting for monthly verification and recording in the COFRS system.

Implementation Date: December 30, 2001.

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## **Medicaid Funds Expended for Department of Human Services Programs**

In January 2001 the Joint Budget Committee (JBC) reviewed a supplemental budget request from the Department of Human Services to address Medicaid overexpenditures totaling approximately \$10.6 million in Fiscal Years 2000 and 1999. In the course of reviewing the request, the JBC became concerned about the management and control of Medicaid funds that are used for Department of Human Services programs.

During Fiscal Year 2001 the Office of the State Auditor conducted a financial review of the overexpenditure of Medicaid funds at Human Services and of the controls that Human Services and Health Care Policy and Financing have established to ensure that expenditures are recorded and reported accurately. The comments below were contained in the *Department of Human Services, Overexpenditure of Medicaid Funds Financial Review*, Report No. 1400, dated May 2001. The financial review contains comments directed at the Departments of Health Care Policy and Financing and Human Services; most of the comments are joint recommendations. The Department of Health Care Policy and Financing is the state agency that administers the Medicaid program. Therefore, for the purpose of this report, all six comments are listed collectively within the Department of Health Care Policy and Financing chapter. Please refer to pages 38 to 48 for details, comments, and recommendations.

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# Department of Labor and Employment

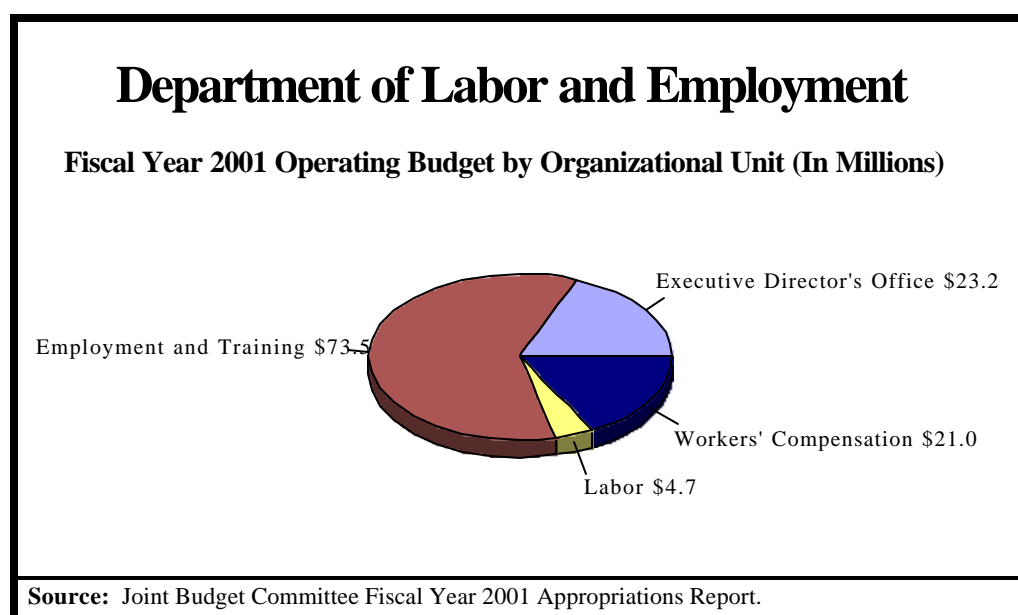
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## Introduction

The Department of Labor and Employment is responsible for promoting and supporting the public economic well-being by providing services to employers and job seekers, and by enforcing laws concerning labor standards, unemployment insurance, workers' compensation, public safety, and consumer protection. The Department is composed of the following major organizational units:

- Executive Director's Office
- Division of Employment and Training
- Division of Labor
- Division of Workers' Compensation

The Department was appropriated \$122.4 million and 1,057.6 full-time equivalent staff (FTE) for Fiscal Year 2001. Approximately 35 percent of the funding is from cash funds and the other 65 percent is from federal funds. The following chart shows the operating budget by major organizational unit during Fiscal Year 2001.





The following comment was prepared by the public accounting firm of Terry & Stephenson, P.C., who performed audit work at the Department of Labor and Employment.

## **Develop Reconciliation Procedures for Grant Expenditures**

The U.S. Office of Management and Budget's Circular A-133 contains the reporting requirements for the State's Schedule of Expenditures of Federal Awards (Schedule). The Schedule lists funds received from the federal government and expended to vendors and subrecipients. The Department prepares its portion of the Schedule from its grant financial system (FARS) and reconciles the amount to COFRS, the State's financial reporting system.

The Department records federal revenue in COFRS. Charges by the State against this revenue are from two sources: direct and indirect allocations. Both direct and indirect federal expenditures are segregated by federal grant award and recorded in FARS.

Fiscal Year 2001 federal expenditures from FARS were approximately \$66.8 million. This amount exceeded the revenue balances in the State's financial reporting system by \$1.9 million. The resulting discrepancy has not been reconciled and appears to be the result of improper matching of indirect allocations and the lack of periodic reconciliations between FARS and COFRS.

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### **Recommendation No. 14:**

The Department of Labor and Employment should develop procedures to isolate and identify the indirect allocation charges for federal grants and perform reconciliations to the State's financial reporting system periodically throughout the year.

### **Department of Labor and Employment Response:**

The Department agrees with the finding and is currently analyzing the problem. We are reviewing federal revenue recording procedures and the timing of reconciliations.

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# Department of Military Affairs

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## Introduction

The Department of Military Affairs consists of the National Guard and the Civil Air Patrol. The Adjutant General is the administrative head of the Department and the Chief of Staff of the Colorado National Guard. The Department is responsible for providing day-to-day command and control, guidance, policies, and administrative and logistics support to the Divisions of the National Guard and Civil Air Patrol.

During Fiscal Year 2001 the Office of the State Auditor, in cooperation with staff from the firm of Cottrell & Associates, conducted a financial review of the Department of Military Affairs. The audit comments below were contained in the *Department of Military Affairs Financial Review*, Report No. 1404, dated November 2001.

## Overview of Federal Funding for Operations

The Department's Fiscal Year 2001 appropriation was just over \$9 million. Of that, over \$5 million is federally funded through a cooperative agreement that establishes the terms and conditions of the federal contribution of funds to support the operation and training of the state Army and Air National Guard.

## Fiscal Responsibility Is Needed

The Department's management has the fiduciary responsibility to ensure that assets are safeguarded and financial transactions are recorded and reported accurately. Annually, state agencies are statutorily required to attest to the State Controller, State Auditor, and Governor that systems of internal accounting and administrative control have been instituted and maintained. State agencies also annually sign a Letter of Certification of Financial Accounting affirming that:

The accounting function is staffed with adequate personnel to assure the accounting is properly carried out and timely, and sufficient monthly accruals are being made to update financial records so that management can properly analyze their financial condition and determine that the

federal government and other parties owing the state are being properly billed.

The Department responded that it was in substantial compliance with these requirements. However, we are concerned about the Department's controls over its financial transactions and the recording and reporting of financial information. The Department has had significant accounting issues over the past few years. During our Fiscal Year 2000 Statewide financial audit, we noted that there was a significant turnover of accounting staff, problems completing required transactions, and difficulty in providing information on a timely basis.

There continue to be significant turnover, delays in processing vendor payments, obtaining federal approvals for reimbursement, and recording additions and deletions to fixed assets.

Overall, we conclude that the Department needs to make improvements in its systems and controls to ensure that assets are safeguarded and that accounting for transactions is timely and accurate.

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## **Recommendation No. 15:**

The Department of Military Affairs should improve its oversight of financial activity and ensure its controls over accounting functions are adequate.

### **Department of Military Affairs Response:**

Partially Agree. Financial controls are in place and are working. Procedures can be improved. The Department is hampered by significant turnovers in accounting personnel, delays in processing and obtaining reimbursements, adjusting fixed asset accounts, and providing timely information. While we agree with this observation, most of those issues are beyond our immediate control.

We cannot require employees to stay. They will leave for upward mobility that we cannot offer in a five-person office. Requests for additional personnel either have not been granted or have been reduced by the Legislature.

Since most transactions are carried out as part of a Cooperative Agreement between the State and National Guard Bureau, we cannot directly control delays in federal invoice approval and payment procedures.

We can control operations within the accounting section and have documented procedures in desk manuals to facilitate inevitable turnover. We have discussed problems with the Cooperative Agreement with federal authorities and have agreement to try to document and streamline processes, and to improve timeliness. We have shifted duties within the accounting section to better balance workload and individual abilities and talents. We are scheduling training on procedures to adjust fixed asset accounts.

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## **Improve the Recording and Reporting of Transactions**

### **Reduce Delays in Processing Transactions**

During our Fiscal Year 2000 audit, the Department experienced a significant turnover of accounting staff and delays in replacing the vacant positions. The situation left the Accounting Section understaffed for the majority of the year. The State Controller's Office provided additional support. Even so, the Department had problems completing all required transactions and providing information on a timely basis. The shortage of accounting staff created additional risk that transactions may have been recorded improperly on the State's accounting system.

During our current review we found that new staff were faced with little or no documentation on department processes and, as a result, struggled to learn the complexities of federal and state regulations that govern transactions. To further compound the problem, during the year, both the accounts payable and the payroll positions were vacant for several months. The new Accounting Section has made significant progress in documenting tasks and processes and in cross-training personnel, but the entire section is still in a learning curve.

We continue to see areas where further improvements should be made:

1. The processing of vendor payments lagged during the year, exceeding the 45 days allowed by Section 24-30-202(24), C.R.S., as other accounting personnel temporarily filled the vacant position. After the position was filled, it took a few months to organize the existing backlog and follow up on potential unpaid balances while researching to ensure that duplicate payments were not made. Our review of May 2001 vendor payments indicates that the Department is improving the

timeliness of payment processing, but there are still some delays related to receiving invoices from the regions and obtaining timely approvals from program managers. For instance, of the May 2001 payables tested, 9 in the sample of 50 were paid between 60 and 174 days after the date of the vendor invoice. These nine payables amounted to a total of about \$119,000.

2. The Department has not updated the State's accounting system for changes in its land, buildings, and construction in progress since Fiscal Year 1999. For example, a land purchase of about \$58,000 is not shown and transfers of buildings to other state agencies, totaling about \$450,000, have not been deducted from the accounting records. During Fiscal Years 2000 and 2001 the Department expended about \$3.7 million in controlled maintenance, land purchases, and construction costs on armories and other buildings but was unable to provide information on the amount of these costs that should be capitalized. The Department also completed construction during this period, but the costs associated with the construction were not properly reflected as a completed project on the State's accounting system. As a result, the amounts reported do not accurately reflect the cost of the assets owned.

Also, in Fiscal Year 2000 buildings and property owned by the Department, valued at \$7.9 million, was transferred to the Department of Public Safety. In Fiscal Year 2001 the Department of Military Affairs determined that the actual cost was about \$2.2 million. Public Safety revised its records to reflect the \$2.2 million cost; however, the building is erroneously being reported on both Departments' books, resulting in an overstatement of assets in the State's financial statements of \$2.2 million.

## **Delays Due to Federal Action or Approvals**

We noted three processes during which a delay in obtaining federal approval or action on an item will slow down or halt the progress of transactions through the accounting system. These include:

- Approval and coding of vendor payments.
- Budget modifications that are required to make federal funding available for spending.
- Federal approval on requests for reimbursements.

## **Approval for Vendor Payments**

For purchases that are subject to federal participation, the Department obtains approval from a federal program manager prior to vendor payment. This confirms the federal commitment to reimburse the State for the outlay, as well as identifies the correct funding source or coding for the payment. However, because the federal approval is in addition to the required state approvals, and there are numerous federal program managers, some on-site, and some at Buckley or other off-site locations, the entire process can be lengthy and may exceed the 45-day state vendor payment guidelines. For instance, some of the overdue May 2001 invoices discussed above were subject to federal program manager approval.

## **Budget Modifications Are Required to Make Federal Funding Available for Spending**

For the large percentage of the Department's budget that is federal and restricted, spending authority and the ability to pay vendor invoices is not available until budget modifications are processed, approved, and entered into COFRS. In some instances, only a month or two worth of spending authority is approved by the federal agency at one time, requiring numerous budget modifications each year. A significant amount of department time is spent obtaining these budget modifications and the related approvals from the federal program managers. In the meantime, the payment of vendor invoices may be delayed pending approval of these budget modifications for federal spending authority.

## **Approval on Federal Requests for Reimbursement**

The Department prepares monthly requests for reimbursement under the federal cooperative agreement. Separate requests are prepared for each of the 12 appendices of the agreement and then forwarded to the appropriate federal program manager for approval. Only after the requests for reimbursement are approved can they be submitted to the federal disbursing agents for payment. Obtaining timely approval from some of the federal program managers has been so problematic during the year that the Department created a spreadsheet to track the progress of each request through the approval and payment process. For instance, the Department's tracking sheets include the following example of delays:

- On December 11, 2000, three requests for reimbursement totaling about \$40,000 were sent to the federal program manager for approval; the approved requests were not returned to the Department until March 6, 2001, three months later.

- On January 8, 2001, two requests for reimbursement totaling about \$68,000 were sent to the federal program manager for approval; the approved requests were not returned to the Department until March 6, 2001, two months later.

During the year, the Department initiated a process of monthly meetings with federal program managers in an effort to increase communication and the timeliness of transaction processing, including federal reimbursements. It is clear, however, that more needs to be done. The Department needs to work with the federal program managers on systems and controls.

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## **Recommendation No. 16:**

In order to reduce delays in processing transactions, we recommend that:

- a. All areas of the Department work with Accounting to streamline the vendor payment process. In particular, the Department should consider various means to identify outstanding payables at the earliest possible date to ensure they are monitored by Accounting for timely approval and payment, as well as recorded in the appropriate accounting period.
- b. The Department continue to work diligently with the federal program managers to streamline the approval processes for vendor payments, budget modifications to make federal spending authority available, and federal requests for reimbursement. Working together to study tracking systems, like the invoice spreadsheet noted above, will help to identify bottlenecks in the approval processes that need to be addressed.
- c. The Accounting Department record changes in fixed assets annually.

## **Department of Military Affairs Response:**

Partially Agree. While the Department agrees with much of the recommendation, the solutions to all the problems are not within our control. For example, personnel turnover in a five-person accounting section can be an extreme detriment, but the Department has only limited ability to influence salary for new hires. The Department has little ability to influence personal decisions of employees who leave because of opportunities for advancement elsewhere. Further, requests for additional FTE have been denied or reduced. We did get

authority and funding to hire a part-time budget analyst and the impact of the new .5 position should begin to be felt this year.

Most transactions are accomplished through a Cooperative Agreement with the federal government and each is subject to approval by the federal program managers. Since the program managers are federal employees who work for federal supervisors, and for each it is an additional, rather than primary, duty, the Department does not exercise direct control over their activities and priorities. This often makes it difficult to get prompt approvals on payments and bills. To further complicate matters, there are 11 Program Managers and they change at the rate of about 4 per year. Recognizing that it is a Cooperative Agreement and that there are problems in execution, the Department and the United States Property and Fiscal Officer, CO, have instituted monthly meetings between the two accounting staffs and with program managers. We have also instituted a comprehensive review of procedures for payments, billings, and accounting to better document and streamline processes where possible.

Within the Department, the accounting section has created desk manuals for each position to document desk procedures and to facilitate inevitable transition of new employees.

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# Department of Natural Resources

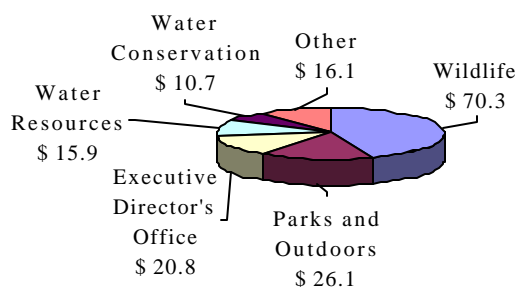
## Introduction

The Department of Natural Resources is responsible for encouraging the development of the State's natural resources. Resources include land, wildlife, outdoor recreation, water, energy, and minerals. The Department operates under the authority of Section 24-1-124, C.R.S., and comprises an Executive Director's Office, which is responsible for the administration and management of the overall Department, and the following eight sections:

- Wildlife
- Water Resources Division
- State Board of Land Commissioners
- Parks and Outdoor Recreation
- Oil and Gas Conservation Commission
- Division of Minerals and Geology
- Water Conservation Board
- Geological Survey

The Department's Fiscal Year 2001 operating budget was about \$160 million with 1,474 full-time equivalent staff (FTE). The Department is primarily cash-funded. Revenue sources include hunting, fishing, and other licenses; royalties and rents; interest; and other sources. The following chart shows the Department's operating budget by division, board, and commission for Fiscal Year 2001.

**Department of Natural Resources  
Fiscal Year 2001 Budget by  
Division/Board/Commission (In Millions)**



**Source:** Joint Budget Committee Fiscal Year 2002 Appropriations Report.

## **Oil and Gas Conservation Commission**

The Oil and Gas Conservation Commission is responsible for regulating oil and gas activities in the State. When oil and gas operations are complete, the Commission is also responsible for ensuring that lands affected by operations are returned to their original state. In Fiscal Year 2001 the Commission was appropriated approximately \$3.4 million and 35 FTE.

### **Ensure Compliance With PDPA Requirements**

Prior to beginning oil and/or gas operations in the State, an operator must submit some form of financial assurance to the Commission showing that an operator is financially capable of reclaiming lands damaged by operations. If an operator fulfills the necessary requirements of reclaiming damaged lands, the financial assurance is refunded. Financial assurance may be submitted in various forms, including certificates of deposit. As of June 30, 2001, the Commission held approximately \$2.6 million in certificates of deposit. Most of these certificates are for the term of one year and perpetually roll over into new one-year certificates.

Beginning with our Fiscal Year 1998 audit, we have found problems with the Commission's compliance with the Public Deposit Protection Act requirements. The Public Deposit Protection Act (PDPA), Title 11, C.R.S., was enacted to protect deposits that either are not insured or are in excess of the insured limit of federal deposit insurance of \$100,000 for each account. One of the PDPA requirements is that public monies are to be deposited only in banks designated as eligible public depositories. This includes most of Colorado's banks. In addition, PDPA specifically excludes investment firms and most out-of-state banks from its coverage.

In both Fiscal Years 1998 and 2000, we recommended that the Commission ensure all certificates of deposit are in compliance with statutory and legal requirements by transferring short-term certificates to eligible depositories on their next maturity date and developing a plan for addressing any long-term certificates. Although the Commission has taken steps to comply with PDPA, we continue to find problems.

### **Certificates of Deposit Are Located at Noneligible Depositories**

In our Fiscal Year 2000 audit the Commission provided us a listing of 31 certificates of deposit, totaling approximately \$333,000, that were held in non-PDPA-eligible financial

institutions. During our Fiscal Year 2001 audit, we reviewed these 31 certificates to determine the current status and found that 15 of the 31 certificates of deposit, totaling about \$190,000, had been moved to eligible depositories and 1 certificate, totaling \$5,000, had been released when operations ceased on the well. This left 15 certificates still not in compliance with PDPA requirements.

During our current audit we found 11 additional certificates, totaling approximately \$49,000, that are not held in eligible depositories. In total, at least 26 certificates of deposit, in the amount of about \$187,000, remain in non-PDPA-eligible depositories. In addition, we found that 2 out of these 26 certificates, totaling \$6,000, had been accepted by the Commission since our Fiscal Year 1998 recommendation.

In 1993 the Division of Minerals and Geology obtained a legal opinion from the Attorney General's Office. The Attorney General's Office determined that financial assurance held by the State qualifies as public monies and should be protected in the same manner as other public monies. The Commission subsequently chose to rely on the Attorney General's opinion for its own financial assurance. As noted in our prior audits, we agree and believe that the Oil and Gas Conservation Commission should take steps to immediately comply.

Section 11-10.5-111(2), C.R.S., states that "it is unlawful for an official custodian to deposit public funds in any bank other than one that has been so designated." Section 11-10.5-111(4)(c), C.R.S., further states that "any official custodian who violates the provisions of this article is guilty of a misdemeanor and, upon conviction thereof, shall be punished by a fine of not less than two hundred dollars nor more than five hundred dollars...." The Commission does not believe it is the official custodian of the certificates of deposit, since the operator is responsible for the actual deposit of a certificate into an eligible bank. Confusion could arise, because certificates of deposit are approved by the Commission, reflected on the State's accounting system, recorded in both the operators' and the Commission's name, cannot be released without the Commission's authorization, and can be foreclosed upon by the Commission in situations where an operator defaults. Determining who is the official custodian/s is an important issue that needs to be clarified immediately.

## **Notify Operators to Transfer Certificates of Deposit in a Timely Manner**

The Commission has had nearly eight years to comply with PDPA requirements. As previously stated, the average certificate of deposit held by the Commission matures annually and is perpetually rolled over into a new certificate. We found that at least four

certificates held in non-eligible depositories have rolled over since our Fiscal Year 2000 recommendation. In one instance, a certificate of deposit rolled over in October 2000 and the Commission did not notify the operator of the need to move the certificate to an eligible depository until March 2001, five months after the certificate was renewed. This certificate of deposit was subsequently moved to an eligible depository in June 2001.

In March 1999 the Commission sent a form letter to all operators explaining PDPA requirements. However, the Commission did not begin to send follow-up letters to operators until September 2000. According to the Commission, it takes an average of six months to transfer a certificate of deposit. We found three instances where an operator was not notified in a timely manner to transfer certificates. For example, letters were sent to two operators one to two months before and one letter was sent two weeks prior to the certificates' maturity dates. None of the above-mentioned certificates have been moved to an eligible depository, and each have been renewed since the notification letter was sent.

The Commission has had ample time to ensure that operators have moved their certificates of deposit before the maturity date arrives. Failure to notify the operator in a timely manner can result in an early withdrawal penalty being assessed against an operator by the financial institution; therefore, the Commission should ensure that operators are given sufficient notice to move a certificate of deposit so that an early withdrawal penalty is not assessed.

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### **Recommendation No. 17:**

The Oil and Gas Conservation Commission should take immediate steps to ensure that all certificates of deposit are in compliance with statutory and other legal requirements by, at a minimum:

- a. Reviewing all certificates of deposit to determine whether they are being held in eligible public depositories.
- b. Notifying operators in a timely manner of the need to move existing certificates of deposit not in eligible public depositories before the next maturity date.
- c. Enforcing the transfer of all certificates of deposit to eligible public depositories.
- d. Working with the Attorney General's Office to determine who should be designated as the official custodian of the certificates of deposit.

## **Oil and Gas Conservation Commission Response:**

- a. Agree. The Commission is on track to meet its July 2002 deadline for compliance as stated in its 2000 Statewide Audit response. The Commission conducted a full review of all certificates of deposit as of November 29, 2001, (193 certificates with a total value of \$2,141,125) and developed a list of 26 certificates that are not yet in public depositories. These 26 certificates of deposit have a combined value of \$187,000 and no individual operator has certificates with a combined value in excess of \$30,000. Of the 26 remaining certificates of deposit, operators using 21 of the noncompliant certificates as financial assurance were each sent a letter dated December 6, 2001, requesting that the funds be transferred to public depositories no later than December 28, 2001. Two additional certificates had not been previously identified and have since been sent compliance letters. Three other certificates of deposit require additional documentation to validate the banks as public depositories, which has been requested.

The Commission will review all certificates before the annual certificate of deposit confirmation letters are sent to depositories in April. The Commission will verify that its financial assurance database includes the Division of Banking PDPA number assigned to the operators. Compliance letters with a resolution deadline prior to July 2002 will be sent to operators that have certificates of deposit that are not in public depository banks or have not provided a PDPA number. Implementation date: July 1, 2002

- b. Agree. The Commission has individually instructed all operators who have certificates of deposit used for financial assurance that are not in approved public depositories to move them to public depositories or provide some alternative method of financial assurance through compliance letters sent in December 2001 and January 2002. This action was necessary to meet the Commission's July 2002 deadline for compliance as stated in its 2000 Statewide Audit response.

The operators have been informed that they are official custodians of the funds because the Commission may only access the funds if the operator fails to meet their environmental or fiscal responsibilities. Since the State may have potential future contingent ownership, the operator's certificates must comply with the Public Deposit Protection Act. Implementation: July 1, 2002

- c. Agree. In Fiscal Year 1998 the Commission directed staff to require operators using certificates of deposits as financial assurance to come into PDPA compliance in a manner that would minimize cost and inconvenience to operators. The majority of the operators complied with this request. The remainder, who received the December 6, 2001 compliance letter, have moved their certificates, provided an alternative form of financial assurance, or have negotiated an extension. The remaining operators with noncompliant certificates of deposit are in the process of moving the funds to approved public depositories or are in the process of converting to insurance bonds.

The Commission currently has one operator scheduled for hearing and one operator who has been sent a Notice of Alleged Violation since they have refused to move their certificate of deposit to public depositories or provide an alternative method of financial assurance. The Commission's Assistant Attorney General has advised that because the Commission does not have ownership of the certificates of deposit, the staff may not convert the certificates to cash without the Commission finding the operator in violation of its rules.

The Commission is closely monitoring compliance deadlines given to operators to meet its July 2002 deadline for PDPA conformity on all of its certificates of deposit used as financial assurance. Implementation date: July 1, 2002

- d. Agree. The Commission has consulted with the Division of Banking on this matter; however, the Commission has directed its Assistant Attorney General to review the matter. Implementation date: July 1, 2002
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## **Division of Wildlife**

The Division of Wildlife is responsible for protecting the wildlife of Colorado. The Division manages over 250 wildlife areas covering 300,000 acres by acquiring habitat lands, preventing the decline of certain species, conducting research, and enhancing the public's awareness of pertinent issues. The nearly one and a half million hunting and fishing licenses sold annually provide the majority of the Division's funding. In Fiscal Year 2001 the Division was appropriated approximately \$70.3 million and 753 FTE.

## **Reduce Number of Cancelled Payments**

In our Fiscal Year 1996 audit, we found problems with duplicate payments at the Division of Wildlife. We recommended that the Department of Natural Resources strengthen management controls over processing and reviewing payments to prevent payment errors. We continued to find problems during our current audit. In Fiscal Year 2001 the Division cancelled about 560 payments totaling approximately \$245,000.

We reviewed 30 of these cancelled payments to determine the reason for the cancellation and found two significant deficiencies. First, the Division does not have procedures in place to ensure that limited license applicants' information is correct in order to send out refund checks. Second, controls over cancelled payments need to be improved. We found that 13 of the payments were cancelled due to inaccurate applicant information, 3 were duplicate payments, and we could not determine the reason for an additional 3 of the cancelled payments. The remaining 11 payments were cancelled for valid reasons. These issues are discussed in further detail in the following text.

## **Develop Procedures to Ensure License Refunds Are Received by Applicants**

We found that 13 of the 30 payments reviewed, totaling about \$2,000, were returned and reissued to limited license applicants. The Division starts to receive limited license applications around the beginning of March each year. After the annual limited license draw, which takes place in June, the Division sends a refund check to all unsuccessful applicants. If the Division does not have an applicant's correct address, the payment is returned to the Division. Often an applicant will notify the Division that a refund check has not been received and the Division will cancel the original payment and reissue the check. This occurred for the 13 payments found during our testwork. Each payment averaged about \$150. In cases where the Division is not notified by an applicant that a refund check was not received, an attempt is made to contact the applicant by various methods, including calling the last known phone number.

During our audit we found a box with approximately 280 unclaimed warrants totaling over \$15,000 (an average of \$54 per warrant) that the Division was unable to return to applicants. When the Division is unable to locate applicants for license refunds, the refund checks are kept for over a year, until they expire. After the checks expire, the moneys are credited back into the Wildlife Cash Fund. The Division maintains a database of all expired license refunds for instances where an applicant later contacts the Division

regarding a missing refund check. However, no attempts are made by the Division to contact the individual after the refund checks expire.

We also found that the Division does not have procedures in place to ensure applicant information in its database is correct. Each license application includes a separate card for change-of-address information. However, if an applicant fills out an application with a new address, but does not fill out the change-of-address card, the database is not updated for the new address. Currently Division staff do not compare the address on the current application with information in the database for repeat applicants. By updating applicant information for address changes from applications, the Division may avoid having a number of unclaimed checks in the future. In addition, the Division does not cross-check current license applicants with its database of outstanding license refunds to determine whether any applicants have unclaimed checks. By performing this cross-check, the Division may be able to return a portion of the outstanding refund checks.

The Department of Personnel and Administration has estimated that it cost the State \$25 to process each payment voucher. The 280 unclaimed warrants that will expire at the end of Calendar Year 2001 not only represent lost revenue for license applicants but also cost the State \$7,000. Since the time frame between when a license application is received by the Division and when a refund check is issued is only about three months, it is likely that a large portion of license applicants can be located. Because returned checks represent the largest amount of payments cancelled by the Division, it is imperative the Division attempt to locate the rightful owner of an outstanding refund check.

## **Improve Controls Over Cancelled Payments**

In addition, we found that 3 of the 30 payments reviewed, totaling about \$6,500, were duplicate payments. The Division continues to have problems with duplicate payments. For example, one purchase was paid for twice because an employee submitted receipts for gas purchased and the vendor submitted an invoice for payment. The Division identified the error in this situation. However, in cases where an error is not discovered by Division staff, it is up to the vendor to notify the Division of the error and to return the overpayment. If a vendor does not bring the duplicate payment to the attention of the Division, there is a risk that the State will not be reimbursed for erroneous payments. The Division could not provide us with explanations for the remaining two duplicate payments.

Finally, the Division did not provide us with explanations for 2 of the 30 cancelled payments. Another payment voucher could not be located by Division staff. These three payment vouchers totaled about \$2,100. We found that the Division does not always



document the reasons warrants are cancelled on the original payment voucher. Therefore, we could not determine whether the cancelled payments were appropriate.

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### **Recommendation No. 18:**

The Division of Wildlife should improve controls to reduce the number of cancelled payments by:

- a. Ensuring applicant information is correct in order to send out limited license refund checks.
- b. Performing a cross-check between returned limited license refund checks and returning applicants to ensure that unsuccessful applicants receive their refunds.
- c. Following up on returned limited license refunds to ensure that unsuccessful applicants receive their refunds.
- d. Documenting the reason a duplicate payment has occurred and developing procedures to identify and address overpayments.
- e. Documenting the reason for cancelling a warrant on the original payment voucher.

### **Division of Wildlife Response:**

- a. Agree. The Division's License Administration Office prioritizes customer-submitted change-of-address forms and/or the bottom portion of the application form to ensure that correct customer addresses are on file prior to any limited licenses or refunds being issued. If refunds are returned for an incorrect address, the bottom of the application is double-checked for a current address. If the customer has written their phone number on the application, the staff attempts to contact the customer via telephone. If phone contact cannot be made, the staff searches the Internet for possible current address information. If any of the above processes result in obtaining current address information for the refundee, the information is entered into the customer file and the refund warrant is re-mailed to the correct address. At the end of the hunting seasons, the above procedures are repeated before the undeliverable refunds are transferred to the Division's cashier office for safekeeping. The above procedures resulted in the delivery of 99.82 percent of all mailed items in 2001. Implementation date: March 15, 2001

- b. Agree. Frequently, reapplying customers realize that they did not receive a refund from the prior year in the situation where refunds have been returned to the Division of Wildlife. When these applicants inquire, the Division of Wildlife provides them with their refund, if appropriate. This process of the applicant querying for returned refunds, in addition to the procedures listed in response to Recommendation a, is designed to accommodate the situations that are most often encountered. Implementation date: March 31, 2003
- c. See response to Recommendation a above.
- d. Agree. The Department of Natural Resources accounting staff has been responsible for cancelling warrants to vendors where duplicate payments or other errors such as the wrong amount have been identified. The Department of Natural Resources has also developed a payment voucher entry manual, which has been distributed to all Division of Wildlife offices, and various policies and procedures for the entry of vendor payments. In cases where warrant cancellations are requested and the issuance of the warrant was in violation of those policies and procedures, Department of Natural Resources accounting team leaders will notify the supervisors of the employee who made the error for review and other action, as needed. Implementation date: February 1, 2002
- e. See response to Recommendation d above.

***Auditor's Addendum:***

***With regard to the Division's response to Recommendations a and c above, there has been an on-going problem with returned license refunds since at least 1992. While we realize that the amount of returned license refunds is not a substantial dollar amount, over time, this amount continues to increase as more refunds are not returned to applicants. We believe that the Division of Wildlife is retaining monies that do not belong to it without making a reasonable effort to locate the rightful owners. While the Division does make an initial attempt to locate applicants, we believe the Division should continue to follow up on outstanding refund checks after they expire.***

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## **Division of Minerals and Geology**

The Division of Minerals and Geology is responsible for regulating mining activities in the State. This primarily includes overseeing the safety and environmental soundness of mining operations. When mining is complete, the Division is also responsible for ensuring proper reclamation of land affected by mining operations. The Division is functionally divided into the coal, minerals, mines, and inactive mines programs. In Fiscal Year 2001 the Division was appropriated approximately \$5.7 million and had 68.7 FTE.

### **Reconcile Internal Systems to the State's Accounting System**

The Division is responsible for accurately maintaining its accounting records by ensuring that adequate internal control procedures are in place. This should include timely reconciliations of internal systems to the State's accounting system to properly monitor activity. During our audit we found that the Division is not reconciling either mined land reclamation deposits or cash receipts information on its internal systems to the State's accounting system. The following narrative provides further detail on these two issues.

#### **Mined Land Reclamation Deposits**

The Division is required by statute to obtain reclamation deposits from mine operators before extracting resources from state lands. These deposits provide assurance that mine and well operators are financially capable of reclaiming land that has been damaged when operations are complete. Operators may submit various forms of reclamation deposits, including certificates of deposit. As of June 30, 2001, the Division held approximately \$4 million in certificates of deposit.

The Division annually confirms certificates of deposit to verify their existence and worth. The certificate of deposit information used for the confirmation process is maintained by the Division in an internal database. During our audit we found that the Division does not have procedures to compare the amounts reported in the internal database with amounts recorded on the State's accounting system. In our Fiscal Year 1999 audit, we found similar problems with the Division's procedures over cash bonds, another form of reclamation deposit. Since Fiscal Year 1999, the Division has developed procedures over cash bonds but has not developed similar ones for certificates of deposit.

We requested that the Division reconcile its internal database with the State's accounting system for certificates of deposit. During this process, the Division found that 10

certificates, totaling about \$59,000, were recorded on the State's accounting system but not on the internal database. Therefore, the Division did not include these 10 certificates of deposit in its annual confirmation process. Without procedures in place to ensure the Division has accurate information, there is a risk that the certificates of deposit may be redeemed without the Division's knowledge. Therefore, there may not be enough money to cover the costs for mined land cleanup in cases where an operator defaults. In these situations, the Division would have to cover such expenses from other sources.

## **Cash Receipts**

The Division uses an internal accounting database as a means of tracking monies received for items such as annual permit fees, sales of publications, civil penalties, and Mine Safety videos. These types of receipts accounted for about \$600,000 of the Division's total revenue in Fiscal Year 2001. Information from the internal database is used by the Division to record cash receipts on the State's accounting system.

During our audit we found that the Division does not reconcile cash receipt documents in the internal accounting database with the State's accounting system. Although we did not find any errors in our testwork, a reconciliation of cash receipts between the State's accounting system and the internal database will help ensure that all moneys are properly deposited and recorded.

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## **Recommendation No. 19:**

The Division of Minerals and Geology should perform a monthly reconciliation between its internal databases and the State's accounting system for mined land reclamation deposits and cash receipts.

## **Division of Minerals and Geology Response:**

Agree. Errors that occurred in the reconciliation of certificates of deposit for bonding were due to data processing and coding inconsistencies when matching the State's accounting system to the Division's mine permit system database. These inconsistencies have been corrected. All of the bonds were accounted for and all active permitted mine sites have bonds in place.

The Division of Minerals and Geology maintains a mine permit system as the primary business application for the Division. This permit system tracks over

2,000 mine operations in the State. Functions contained in the Permit System are for reporting and document generation. There are about 20 standard reports, such as monthly progress reports, fee reports for the staff, information on inspections, bonds, violations, and all environmental information on mine operations in the State. There are over 500 documents that are generated from the system including correspondence, reports, and legal notices.

In 1999 the system was rewritten due to some minor Y2K issues and due to the Department's standardization on the Microsoft Office Suite and Microsoft NT network. The Division continues to upgrade this permit database and will incorporate the needed reporting for monthly reconciliation.

Although the audit did not find any errors in the reconciliation of cash receipts, the Division understands the importance of reconciling the State's accounting system with the Division's internal system. The Division uses Quickbooks programming for tracking incoming cash receipts and has added a procedure to incorporate the reconciliation process.

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# Department of Personnel and Administration

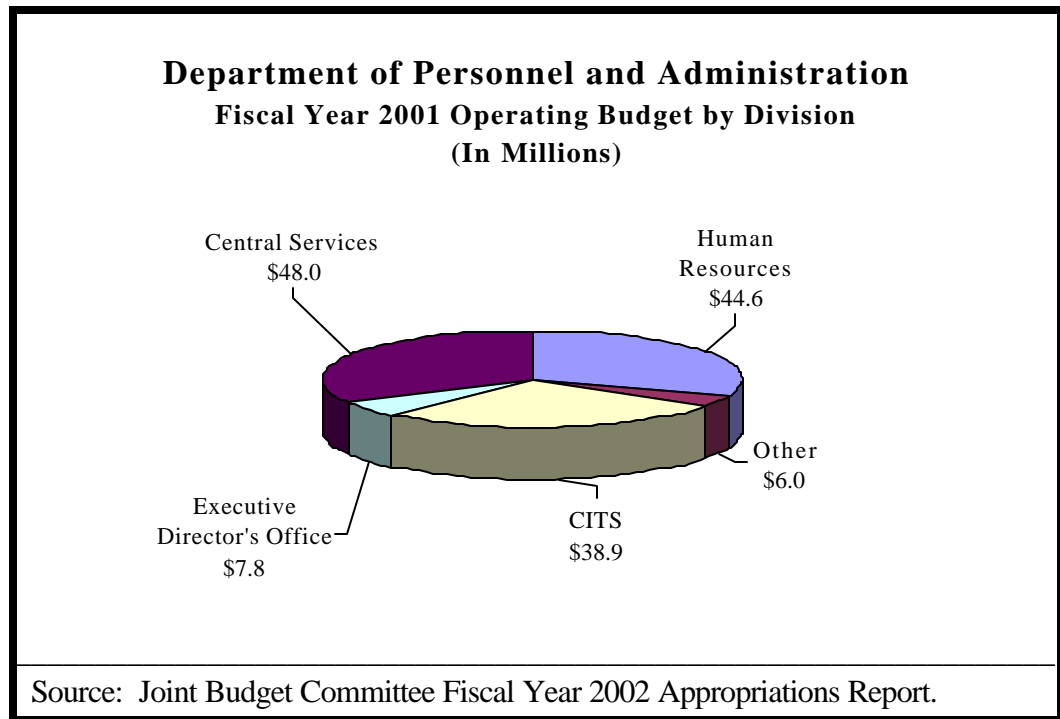
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## Introduction

The Department of Personnel and Administration's primary function is to support the business needs of state government. The Department administers the classified personnel system, which includes approximately 28,000 employees, (excluding the Department of Higher Education) and provides general support services for other state agencies. The Department of Personnel and Administration includes the following divisions:

- Executive Director's Office
- Human Resources Services
- Personnel Board
- Central Services
- Finance and Procurement
- Colorado Information Technology Services
- Administrative Hearings

The Department was appropriated total funds of \$145.3 million and 587 full-time equivalent staff (FTE) for Fiscal Year 2001. Approximately 11 percent of the funding is from general funds and 89 percent is from cash funds. Cash funds include vehicle and building rentals, copying, printing, graphic design, and mail services. The following chart shows the operating budget by division/unit for the largest divisions during Fiscal Year 2001.



## Monitor Sick and Annual Leave

The Department of Personnel and Administration is charged with oversight functions in matters of personnel. According to Section 24-50-101 (3)(c), C.R.S.:

The state personnel director shall provide necessary directives and oversight for the management of the state personnel system and in discharge of his constitutional duty to administer the state personnel system.

The Department is responsible for overseeing all major statewide human resource programs and systems, including employee benefits, risk management, job evaluation, compensation, recruitment and selection, consulting and training, and personnel rules development and interpretation. These duties are delegated to the Division of Human Resources, which conducts periodic audits of statewide human resource functions.

As part of our annual statewide audit, we review personnel costs at various agencies on a sample basis. This year we reviewed sick and annual leave at the Department of Law, the Department of Natural Resources, the Office of the Governor, the Division of Central Services in the Department of Personnel and Administration, and the Department of

Revenue. Specifically, we examined the controls and processes for recording annual, sick, and other compensatory leave. We reviewed 85 personnel files for Fiscal Year 2001.

During our audit we found several common problems with the controls and processes for tracking and recording employee leave. Specifically, we found that:

- **Eleven percent (9 out of 85) of employees had leave request forms not signed by a supervisor.** We found one example of this at both the Department of Law and the Office of the Governor. Central Services had 7 employees with a total of 11 request forms that were not signed by a supervisor, representing more than 100 hours of leave.
- **Eight percent (7 out of 85) of employees had one or more leave request forms (nine total forms) that were not updated in the leave tracking system.** As a result, leave time that was taken was not deducted and employees were not properly apprised of their balances. There is also a risk that balances may be overstated, resulting in extra costs to the State. At the time of testing in June 2001, the forms ranged from one to eight months old. We found this problem three times each at Central Services and the Department of Law and once at the Office of the Governor.
- **Five percent (4 out of 85) of employees had leave time recorded without a request form, representing 26 hours of leave.** This involved files for three employees at Central Services and one employee at the Office of the Governor.
- **More than one-half (13 out of 25) of the employees' leave balances reviewed at Central Services contained mathematical errors.** We noted six individuals who had one month's activity posted two or more times. This resulted in both leave taken and leave earned being recorded several times, with the balances subsequently misstated.

In general, we found inadequate review over the leave tracking and recording function. It does not appear that agency controls that are in place are effective in preventing errors in employee leave balances. Without complete and accurate leave information, employees may take time off inappropriately, expenses may be recorded incorrectly, and managers may not have the information needed for policy-making decisions. This is compounded by agencies' using a variety of leave systems to track employee leave balances, ranging from manual leave cards to spreadsheets to full automation.



The Department of Personnel and Administration should incorporate the review of leave controls and processes into its examinations of the State's human resource programs. This action will provide the Department with vital management information and assist in their efforts to comprehensively manage and oversee the various human resource systems in the State's decentralized environment.

The Department is working toward a more comprehensive statewide leave management system. The individual, segmented leave systems currently in use make it very labor-intensive for the Department to gather management information needed to fulfill its monitoring and oversight functions. In addition, many of the various systems are complex and difficult to navigate and integrate, increasing the cost of using the systems and the possibility for errors, such as those found in our audit. A pilot program, Kronos, is currently being tested in two state agencies. We believe that the Department should continue to develop a more comprehensive statewide system that provides access to management information, is more user-friendly, and is made available to all state agencies.

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### **Recommendation No. 20:**

The Department of Personnel and Administration should monitor sick and annual leave on a statewide basis by:

- a. Reviewing the adequacy of leave tracking systems as part of their oversight of the State's human resource systems.
- b. Establishing a project schedule and deadlines for implementing a statewide automated leave system.

### **Department of Personnel and Administration Response:**

- a. Agree. The Division of Human Resources is responsible for overseeing the statewide human resource functions including the application by agencies. The Consulting Services Unit performs the audits to monitor and evaluate the state personnel system. This unit is currently redefining the auditing function and developing an audit methodology and evaluation standards that will be shared with the agencies. In determining the audit schedule, leave management is one area that is to be audited first. The audit review of each agency's policies,

processes, and systems regarding leave tracking will be part of these audits. This audit is tentatively scheduled to begin prior to June 2002.

Implementation date: Starting June 1, 2002 and then ongoing.

- b. Agree. The Department of Personnel and Administration is committed to providing the necessary support and infrastructure for the statewide timekeeping (including leave tracking), providing funding is made available. The Departments of Public Health and Environment and Natural Resources have implemented the statewide pilot timekeeping system, Kronos, and the Department of Public Safety is beginning implementation. These departments and the Department of Personnel and Administration contributed funding for the pilot project. In addition, the Departments of Human Services and Labor and Employment are currently using a separate and self-administered version of the Kronos system. These departments are planning to migrate to the statewide Kronos system in the future. Other departments are considering joining the statewide system as well.

The Department of Personnel and Administration does not have funding to implement the Kronos system on a statewide level. As each additional department joins the statewide system, they will work with the Department of Personnel and Administration and the software vendor to identify the incremental costs. These costs may include software licensing costs, software implementation costs, additional infrastructure costs, and ongoing operational costs.

Implementation Date: June 30, 2003.

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## Improve Controls Over Payroll

In Fiscal Year 2001 the Department of Personnel and Administration had an annual gross payroll of approximately \$24 million for its 503 full-time employees and an annual gross payroll of approximately \$1.4 million for its 69 part-time employees. During our audit we found the following:

- The payroll process duties were not segregated. The employee directly associated with processing payroll was also reconciling the payroll expense. The

Department's payroll process should be segregated. The Department has adequate staff to allow for segregation of duties.

- The independent division verification of payroll eligibility is not adequately reviewed by the Department's Human Resource Section. To compensate for the lack of segregation in the Human Resource Section's payroll process, each division is requested to review and verify its monthly and bi-weekly payroll expense and acknowledge in writing that the payroll expense is accurate. We found that more than 50 division acknowledgment letters had not been reviewed and some divisions had not acknowledged the accuracy of their payroll expense within the previous two to three months. In addition, we could not determine if payroll expense reports were actually sent to all the divisions each pay period.

While we did not identify any payroll errors during our testwork, a sound control system will mitigate the risk of errors or irregularities.

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### **Recommendation No. 21:**

The Department of Personnel and Administration should ensure that:

- a. The payroll process duties are segregated.
- b. All divisions receive and review their payroll expense reports, and payroll staff review and verify that each division confirms the accuracy of its monthly and biweekly payroll in a timely manner.

### **Department of Personnel and Administration Response:**

- a. Agree. The Department of Personnel and Administration is currently going through a reorganization of internal departmental functions. As part of that reorganization the Department's payroll and human resources functions will be moved from the Division of Human Resources to the Executive Director's Office. This will provide adequate staff to allow for the proper segregation of payroll duties.

Implementation Date: March 1, 2002.

- b. Agree. The necessary steps will be taken to ensure independent verification of payroll eligibility is performed in a complete and timely manner.

Implementation Date: March 1, 2002.

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## Improve Procedures and Controls Over Payment Vouchers

Central Collections, an agency within the Department of Personnel and Administration, is responsible for collecting debts owed to state agencies and local governments and disbursing collections to them. The agency's internal debt collection system, Columbia Ultimate Business System (CUBS), manages 450 client agencies and 229,000 accounts totaling \$191 million as of June 30, 2001. In Fiscal Year 2001 Central Collections collected nearly \$11.8 million in debts owed.

The Executive Director's Office (EDO) is responsible for reviewing supporting documentation, such as detailed billing information and approving payments to state agencies and local governments. We found that the EDO approved Central Collection's payments without reviewing supporting documentation. The same problem existed in our 1996 audit and the EDO agreed to implement procedures to review supporting documentation before approving payments. We did not find any errors during our Fiscal Year 2001 testwork; however, an established approval process can mitigate the risk of errors.

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### Recommendation No. 22:

The Department of Personnel and Administration, Executive Director's Office, should implement procedures to review Central Collections' supporting documentation prior to approval of payments.

### Department of Personnel and Administration Response:

Agree. The Department will implement the necessary procedures to ensure that independent review of supporting documentation is performed prior to approval by the Executive Director's Office.

Implementation Date: March 1, 2002

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## State Controller's Office

The State Controller's Office (SCO) is organizationally located within the Department of Personnel and Administration. The Office is under the direction of the State Controller, who is appointed by the Executive Director of the Department of Personnel and Administration. The SCO is responsible for the State's financial affairs and reporting on the operations of the State as a whole, including the following functional areas:

- **Administration.** This area includes the State Controller and the Deputy State Controller, who are responsible for establishing financial guidelines and fiscal policies for the State's agencies.
- **Reporting and Analysis.** This area is primarily responsible for compiling the State's General Purpose Financial Statements as well as various other statutorily required reports.
- **Financial Accounting Specialists Team.** The members of this team provide various accounting services to State agencies, including assisting them in implementing new guidelines and addressing specialized accounting needs.
- **Central Accounting.** This area's primary responsibility is to issue warrants for the State's obligations.
- **Cost Accounting.** This area develops the statewide indirect cost plan.
- **Procurement.** The State Controller oversees the State's procurement functions.

The State Controller's Office was appropriated 38.5 FTE staff in Fiscal Year 2001.

## Ensure Problem Areas Are Resolved

The mission of the State Controller's Office is to manage the State's financial operations and provide quality statewide financial information. The SCO routinely works in partnership with state agencies, which on a daily basis conduct the State's business and record the related transactions on the State's accounting system, COFRS. The SCO staff are in continual contact with agency accounting staff and analyze information in COFRS on a regular basis. These activities provide the SCO with feedback on financial issues.

Despite the SCO's involvement, we have seen problems at two of the State's largest departments that have continued over a number of years.

**Department of Health Care Policy and Financing (HCPF).** HCPF oversees the State's Medicaid program, which is the largest federal program administered by the State. The Medicaid program is funded approximately equally by state general funds and federal funds and had expenditures of over \$2 billion in Fiscal Year 2001. As part of its responsibilities, HCPF tracks the accounts receivable due to the State from the federal government after general funds have been expended for the Medicaid program. In Fiscal Year 1996 the Statewide Single Audit reported that HCPF had inadequate controls over the various accounts receivable for the Medicaid program. The audit recommended that the Department improve its management of these accounts by completing reconciliations and strengthening controls.

Subsequent audits reported that the recommendation was "partially implemented" because, although the Department had been able to reconcile some of its receivables related to the Medicaid program, it had not been able to reconcile the largest one, the receivable from the federal government. After considerable effort over several years, in Fiscal Year 2001 the Department completed the reconciliation and concluded that the receivable was overstated and had to be reduced by \$15.9 million. This amount represents almost 14 percent of the \$116.2 million federal receivable prior to the reduction. (For additional information about HCPF and this write-off, see Recommendation No. 3).

**Department of Human Services (DHS).** DHS oversees the State's programs for public assistance, mental health, developmental disabilities, youth corrections, vocational rehabilitation, veterans, and numerous other areas. This Department had total expenditures of about \$1.8 billion in Fiscal Year 2001 and is responsible for some of the State's other large federal programs. Some of these programs and their total Fiscal Year 2001 expenditures from all sources include Temporary Assistance for Needy Families, or TANF (\$197.6 million), Food Stamps (\$179.1 million), and the Social Services Block Grant (\$85.2 million). Since Fiscal Year 1995, the annual financial audits have identified problems with cash management related to federal receivables at DHS on a regular basis. Specifically, the Department has not drawn down federal funds in a timely manner for all of its federal programs after state general funds have been expended. The Department has made efforts to address this problem, as well as other issues, by reorganizing accounting staff and functions and implementing a new county financial information system. However, the Fiscal Year 2001 audit again identified large balances in the federal accounts receivable for four of the Department's largest federal programs. This indicates that in these cases DHS still was not requesting reimbursement from the federal government as soon as it should. For a fifth program, the Department had drawn federal funds in advance of state expenditures, which is a violation of federal regulations. (For additional information about DHS cash management, see Recommendation No. 66).

## Management of State Finances

The longer problems persist, the more difficult it may be to determine their source and the more likely they may result in costs to the State. In the case of HCPF, it is not known if the \$15.9 million was originally a valid receivable that should have been collected from the federal government, or was a result of erroneous entries not discovered previously. If the \$15.9 million was a valid receivable, the write-off represents an expenditure in general funds because the State did not receive the federal reimbursement. However, because the problem was not identified until at least three years after the entries in question occurred, and because of difficulties locating detailed accounting data, HCPF was unable to determine the specific entries that created the \$15.9 million. In any case, since there is a two year limit under federal Medicaid regulations for requesting reimbursement, the amount is not collectible at this time.

In the case of DHS, the lack of timely draw downs of federal funds for programs such as TANF means that the State loses the use of those general funds longer than it should. In other words, the State unnecessarily loses interest on general funds used to front the federal share of expenditures prior to the receipt of federal reimbursement. In Fiscal Year 1998 the audit estimated that approximately \$107,000 in interest was lost over a six-month period.

The SCO's assistance and guidance to state agencies is vital to ensuring that the State's finances are properly managed; adequate controls are in place to safeguard state assets; and financial reports are accurate, timely, and provide an appropriate basis for decision making.

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### Recommendation No. 23:

The State Controller's Office should assess ongoing problems identified during audits on the basis of risk, and assist agencies in addressing and resolving problems considered high priority for the State.

### State Controller's Office Response:

Agree. The State Controller's Office does assist state agencies in resolving problems identified during financial audits. We are deeply troubled by the \$15.9 million dollar adjustment to the federal receivables at HCPF and became aware of it shortly before closing the books. This adjustment was identified as a result

of that department responding to prior audit recommendations. Based on statements by the accountant involved, we believe that the error resulted from an over-accrual of federal revenue that occurred over a number of years. If this is the case, this represents an accounting error; it does not represent an under-collection of federal revenue. However, we have not yet been able to verify this explanation. The State Controller's Office will continue to investigate the transactions that may have led to this required adjustment.

To be implemented by June 30, 2002, and ongoing.

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## **Record Write-Offs of Accounts Receivable in the Current Fiscal Year**

Another concern identified during the Fiscal Year 2001 audit was that the State Controller's Office recorded the offset to the \$15.9 million write-down in accounts receivable, discussed in the previous section, as a decrease to the prior year's fund balance in the State's Fiscal Year 2001 financial statements. In our opinion, the offset should have been recorded as a bad debt expense in Fiscal Year 2001. Recording the \$15.9 million as a bad debt expense is consistent with the treatment of other reductions to accounts receivable for uncollectible amounts, and clearly identifies the adjustment in the current year.

In making its decision, the SCO used accounting standards that address how adjustments for errors and for changes in estimates should be reported. Standards require that the correction of an error be reported as an adjustment to the prior period, if the error is discovered during the current fiscal year but is attributable to an earlier year. On the other hand, a "change in estimate" is to be reported in the current fiscal year, regardless of whether the original estimate was made in the current year or an earlier year. In the case of the \$15.9 million reduction, the State Controller's Office concluded that the reduction was the correction of an error or errors made in prior years and therefore must be treated as a prior period adjustment.

We are concerned that there is no documentation supporting the conclusion that the \$15.9 million was an error or collection of errors. It is equally likely that the \$15.9 million was at one time a valid receivable. Various audits conducted by our office of the Medicaid program have identified problems with oversight of the financial aspects of the program. In particular, the *Overexpenditure of Medicaid Funds Financial Review* conducted by the Office of the State Auditor (discussed in the Department of Health Care Policy and



Financing recommendations 4 through 9 in this report) found a serious lack of oversight and accountability on the part of both HCPF and the Department of Human Services (DHS) for expenditures for two parts of the Medicaid program administered by DHS. These problems have likely existed since the reorganization of state departments effective Fiscal Year 1995, and they also could have resulted in, or contributed to, misstated receivables. If this is the case, the \$15.9 million represents not only an adjustment to accounts receivable, but also a loss of federal revenue to the State.

Receivable amounts deemed uncollectible are routinely reported in the current period as an expense to that period. For example, in Fiscal Year 2001 the SCO recorded another, separate write-down in accounts receivable in the amount of about \$2.1 million from Medicaid providers as a bad debt expense in Fiscal Year 2001. Thus, the SCO did not handle the two Medicaid-related write-offs consistently with respect to reflecting the expense as current year activity. For the provider receivable, there was an allowance for uncollectible accounts, and the offsetting entry increased the allowance, rather than directly decreasing the receivable itself.

## **Disclosure of Adjustments in Current Year**

Equally as important as the discussion of accounting standards, however, we believe that write-offs to accounts receivables and other adjustments affecting the State's assets should be disclosed as part of the current year's financial activity in order to ensure full accountability for these transactions. In this case, there is general agreement that the \$15.9 million overstatement was the result of poor accounting practices, and the lack of a basic control over the Medicaid program. Such instances need to be fully disclosed, and in our opinion, recording these as current year adjustments is the most straightforward manner of achieving this.

In addition, recording such adjustments as a current year transaction prevents manipulation of the year's financial results by moving adjustments into prior years. This is particularly important because state spending is limited by several legal requirements, such as the 6 percent limitation on the annual increase in general fund expenditures under the Arveschoug provision (Sec. 24-75-201.1, C.R.S.). In this case, because the \$15.9 million was treated as a prior period adjustment, it will not become part of the Fiscal Year 2001 base upon which the 6 percent limit in general fund expenditures is calculated for Fiscal Year 2002. If the \$15.9 million had been treated as a budgetary expense in Fiscal Year 2001, this would have increased the Fiscal Year 2001 base by \$15.9 million and would have potentially decreased the amount of money available for transfer into the Highway Users Tax Fund in Fiscal Year 2002. In the case of the Medicaid provider receivable reduction

of \$2.1 million discussed earlier, this was treated as a budgetary expense for Fiscal Year 2001.

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### **Recommendation No. 24:**

The State Controller's Office should record write-offs of uncollectible accounts receivable as a current year expense in the year in which the determination is made, unless specific, documented evidence of entries exists that attributes the adjustment to an error or errors made in a prior period.

### **State Controller's Office Response:**

Partially Agree. The State Controller's Office does record write-offs of uncollectible receivables in accordance with generally accepted accounting principles. We do not believe that recording a current year expense is always appropriate. The write-off of the \$2.1 million of Medicaid provider receivables was properly shown as an expense because expenditures had been reduced when the receivables were established. However, write-offs of tax receivables are recorded as a reduction of current year revenue because revenue was overstated when the receivables were originally established. Prior period adjustments are only recorded for errors made in a prior period that are of such a size that showing them as current period adjustments would materially distort current year revenue or expenditures. The State Controller's Office will continue to discuss with the Office of the State Auditor, the Joint Budget Committee Staff, and the Office of State Planning and Budgeting, the most appropriate way to reflect these types of adjustments against the current year budget.

To be implemented by June 30, 2002.

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## **Improve Timeliness of Initial Electronic Funds Transfer Payments**

The State makes payments to vendors in one of two ways, by check or by Electronic Funds Transfer (EFT). In Fiscal Year 2001 about \$4.6 billion of payments were made by EFT and \$3.9 billion were made by check. These amounts do not include checks for income tax issued by the Department of Revenue and unemployment insurance checks issued by the Department of Labor and Employment.

EFT payments have advantages over paying by check. EFT transactions cannot be lost in the mail and the State Treasurer's Office is able to better predict the State's cash flow. Although float time is reduced, the predictability of EFT transactions allows money to be kept in higher-yielding investments for longer time periods. These advantages are lost when manual checks are issued.

When a vendor initially requests to be paid by EFT, the State Controller's Office enters the vendor information into the State's accounting system and sends a prenotification to the vendor's financial institution. The prenotification is a zero-dollar EFT transaction that is used to verify that the account information is accurate. If the prenotification is not rejected, the State will send the first EFT payment 17 days later.

During our audit we identified a problem with the time period between when a vendor signs up to receive payments by EFT and when the initial payment is made to the vendor. Currently the State's accounting system is programmed to transmit a prenotification and to wait 17 days for a response from the vendor's financial institution before initiating the EFT payment. In some instances, this delay has necessitated the issuance of manual checks to ensure payments are made within the statutory 45-day deadline.

We contacted six financial institutions to determine whether the State's prenotification process was reasonable. The banks we contacted had time periods ranging from two days to two weeks, with the standard being about one week. All of these time periods were less than the State's 17 days. In addition, we found that the National Automated Clearing House Association, the national rule-making body governing electronic payments through the Automated Clearing House system, no longer requires prenotifications when initiating EFT transactions.

We believe that the State Controller's Office should eliminate the prenotification requirement or reduce the time period so that initial EFT transactions will be processed in a timely manner. This change would require reprogramming the State's accounting system to accept a shorter time period. The State Controller's Office should work with Colorado Information Technology Services staff to coordinate any system changes.

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## **Recommendation No. 25:**

The State Controller's Office should eliminate the prenotification requirement or reduce the time period to ensure initial EFT payments to vendors are made in a timely manner.

### **State Controller's Office Response:**

Agree. The State Controller's Office will review the need for the prenotification process. If it is determined that it will still be required, we will work with the appropriate parties in the Department of Personnel and Administration to implement the needed system changes to reduce the time required to initiate EFT payments.

To be implemented by June 30, 2002.

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## **Colorado Information Technology Services**

Colorado Information Technology Services (CITS) integrates the State's information services. The Division's responsibilities include planning, coordinating and integrating communication capabilities for data, voice, radio, and wireless technologies; planning, managing, operating, and delivering the State's computer infrastructure (such as desktop microcomputers, mainframe resources, and data entry services); developing data sharing technologies; archiving historical records; and supporting all statewide applications (including payroll, personnel, financial, and purchasing systems). The State Archives is a unit of CITS.

### **State Archives**

The Colorado State Archives' mission is "to ensure the preservation of the state's permanent legal records and information and to promote their use by the citizens of Colorado." Archives provides records and archive management and micrographics assistance to state and local government agencies. Archives' information and research functions provide for citizen access to public records created by the legislative, executive, and judicial branches of state government. Archives was appropriated 11 FTE to carry out its functions in Fiscal Year 2001.

## **Records Management Processes Need Improvement**

Section 24-80-102, C.R.S., states that the Executive Director of the Department of Personnel and Administration is responsible for the proper administration of public records.

For all practical purposes, this duty is delegated to the State Archivist. Agencies are allowed by statute to appoint records liaison officers to help with the performance of the duties and functions concerning state archives and public records. These officers aid in the oversight of records management processes at their agencies by monitoring compliance with the State's Record Retention Manual, creating policies and procedures regarding record retention and destruction, ensuring that records are purged and destroyed according to established schedules, establishing protocols for the safeguarding of confidential records, and serving as a resource for agency personnel.

Archives works with the records liaison officers to develop and approve retention schedules for agency records. Retention schedules and destruction requests are approved by the executive director of the requesting agency, the Attorney General's Office, the State Archivist, and the Office of the State Auditor.

As part of our audit, we sent records management policy and procedure surveys to 22 Colorado state agencies encompassing all three branches of government. In addition we surveyed records management personnel from five surrounding states. We also performed testwork at the State Archives and various state agencies. During our testwork we noted several ways in which the State's records management processes could be improved. In addition, we found a general lack of awareness of basic records management requirements and practices and a lack of overall information. For example, we were unable to obtain basic information such as the amount of storage space used, number of records stored, and records storage costs.

## **Improve Communication About Records Management Policies and Procedures Among Agencies**

We found one agency was not updating its record retention schedules on a regular basis; four agencies were not aware that records retention policies and procedures must be approved by the State Archivist, Attorney General's Office, and Office of the State Auditor; and several agencies had schedules that did not include all agency records. Schedules should be reviewed and updated periodically to ensure that they are appropriate and that records are being kept and purged in an efficient manner.

Six agencies were not aware that record liaison officers should be appointed for each department. We obtained a listing of record officers from the Archives and noted the record liaison officers listed for these six agencies were no longer responsible for those duties, or only were responsible for their division.

None of the agencies surveyed requested detailed billing statements from DocuVault, the State's approved record storage vendor. DocuVault allows customers to indicate the level of detail they prefer on their monthly statements. If an agency does not specify the type of statement, the default monthly billing will only show a total amount due. If agencies do not request detailed billing statements, there is no way to ensure that they are being charged for the correct services.

## **Purge Records Annually**

Four of the twenty-two agencies reviewed were not purging records on an annual basis and were keeping records longer than needed. Although annual purging is not required by statute, records should be purged regularly so that unnecessary items are not retained, resulting in extra storage costs to the State.

Records should be destroyed in compliance with Section 24-80-105, C.R.S., which requires approval of the Attorney General's Office and the State Archivist before records are destroyed. We noted multiple instances where record liaison officers stated they were unaware of this requirement. When records disposal is not properly approved, items with a business, legal, or audit value may be destroyed inadvertently.

## **Improve Maintenance and Storage of Records**

None of the state agencies we surveyed were able to produce an inventory listing of records. Although this is not required by statute, it is essential for records management. An inventory of stored records should be kept so that the retention and disposal processes can be efficiently managed and so that agencies are aware of the number and location of the records they possess.

All records should be stored appropriately. We noted two agencies using off-site storage facilities that were not climate-controlled. Records stored in such areas may be subject to the variations of the weather or to pest infestation, which may cause damage or destruction.

Agencies should use the most cost-effective record storage methods. Specifically, agencies are storing records themselves when it may be more cost-effective to use the state-approved vendor. The State entered into a price agreement with DocuVault to provide record retention services for Fiscal Year 2002. For records that are not needed on a frequent basis, it may be more cost-effective for agencies to use DocuVault's services than to maintain their own storage facilities. Using DocuVault would also free up space in state buildings that could be used for other purposes.

## **Obtain Records Information and Create a Records Management Users Group**

The above problems indicate a fundamental lack of awareness and disregard on the part of state agencies for records management. Archives could remedy this deficiency by:

- Working with the General Assembly to establish standards for records management including, but not limited to, requiring the appointment of a records officer for each department, periodic inventories of agency records, and the appropriate destruction of agency records.
- Requiring inventory listings of records stored and storage space used from each agency. This information would assist in efficiently managing retention and disposal processes and provide information on the cost of record storage at each agency.
- Creating a users group to achieve better communication between agencies and Archives. Such a group would provide a forum for records liaison officers to discuss issues and concerns relating to their duties. It would also provide a mechanism for Archives to disseminate information relating to retention requirements and best practices and to provide opportunities for additional training. During our testing we noted a tremendous disparity in the experience of the records liaison officers. Some officers were very knowledgeable about the process, while others were not. A users group would allow new records liaison officers to draw on the experiences of their peers in an informal environment. Since Archives possesses the necessary expertise, it should take the lead in coordinating such a group.

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### **Recommendation No. 26:**

The State Archives should work with the General Assembly to establish standards for records management.

#### **State Archives Response:**

Agree. The State Archives will work with the General Assembly this summer and fall to establish such standards. Legislative change will be sought in the 2003 session.

Implementation Date: June 30, 2003.

**Recommendation No. 27:**

The State Archives should require the submission of inventory listings of records stored and storage space used from each agency.

**State Archives Response:**

Agree. We will proceed to establish a process to collect this information from the agencies and anticipate beginning to request this information in July 2002. If agencies do not respond to our request, we will note this and advise the Office of the State Auditor.

Implementation Date: June 30, 2003.

**Recommendation No. 28:**

The State Archives should improve communication regarding records management requirements among state agencies by creating a users group. This group should include records liaison officers from each agency, should meet on a regular basis, and should address:

- a. Records management policies and procedures.
- b. Purging and destroying records.
- c. Maintenance and storage of records.

**State Archives Response:**

Agree. The State Archives will establish a records management users group as recommended. We will move forward to develop a process whereby the group will meet quarterly beginning with Fiscal Year 2003 to address these issues.

Implementation Date: July 15, 2002.

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## **Convert to an Electronic Cataloging System**

Archives maintains a catalog of all permanent records in its possession in a paper format. Agencies provide Archives with two copies of the Public Records Register, detailing the items to be stored. Archives stamps a record location on the copies and files them in binders called Finding Aid Guides for each agency. When locating a record, Archives personnel must manually locate the Public Records Register for the item. Because this information is filed manually, there is only one access point to look up records. For example, information cannot be retrieved from different computer terminals or other remote locations. Archives also does not have the ability to perform searches by topic or keyword, leading to more effort and time spent by staff in retrieval.

There are a variety of systems available that could aid in tracking the records Archives keeps. These range from off-the-shelf database software to programs created by agency staff. An electronic cataloging system would allow Archives multiple access points to retrieve information and to process requests more quickly and efficiently. Items could be retrieved using a variety of search terms in addition to the item number. Archives should investigate the options available and convert its existing inventory from a paper to an electronic format for its cataloging system.

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### **Recommendation No. 29:**

The State Archives should investigate the various options available and convert its current cataloging system from a paper to an electronic format.

### **State Archives Response:**

Agree. Efforts are currently under way to determine what the scope and resource requirements of this project would entail. Our goal would be to make the information available on the Internet as well. If the spending authority, funding, and technology are available, this process could begin in Fiscal Year 2003.

Implementation Date: June 30, 2003.

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## **Improve Records Management Training Provided to State Agencies**

Archives provides records management training to agencies upon request. This training covers basic records management topics, such as the duties of the records liaison officers. As of October 2001, Archives had not provided any training to agencies other than on demand. However, we noted that several statewide training sessions are now available with dates listed on Archives' Web site. Although this is a step in the right direction, we believe that Archives should take further steps to publicize available training services.

As part of our survey of state agencies, we asked if records liaison officers had attended an Archives-sponsored training session and, if so, their opinion of the quality and value of the information they received. Individuals who stated they had attended the training had a high opinion of the content and quality. However, we noted that 9 of the 22 records liaison officers stated that they were unaware that Archives offered such training.

It is important that records liaison officers receive training on their duties. Staff at four out of the five states we surveyed stated that they provided at least annual training sessions. We believe that Archives should take steps to publicize its training program and conduct at least annual training sessions for all agency records liaison officers.

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### **Recommendation No. 30:**

The State Archives should ensure that training is available to all agencies by:

- a. Taking steps to publicize the type and nature of training that is available.
- b. Conducting general training sessions for all agency records officers on at least an annual basis.

### **State Archives Response:**

Agree. The State Archives can expand information about the training opportunities that are available to state agencies. However, there is a need for additional records management FTE to do the job well. At present only a .5 FTE is available for statewide records management. Conversely, our neighboring states

have anywhere from 3 to 12 full-time records management FTE assigned to this responsibility.

We will plan for an annual records management training session beginning in Fiscal Year 2003 assuming funding and resources are available.

Implementation Date: August 1, 2002.

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## **Central Services**

The Division of Central Services is responsible for providing basic services needed in all state agencies. These services include mail processing, messenger services, management of the statewide travel program, copying, printing and graphics design, microfilming, vehicle leasing, management of the State's motor vehicle fleet, and collection of overdue accounts. Central Services is funded entirely from fees paid by state agencies.

## **Improvements Are Needed in Direct Billing Systems**

Central Services directly bills other agencies more than \$10 million each year for centralized services. Automated billing systems generate bills and interface with the State's accounting system, as well as provide various management reports.

During our audit we identified the following control issues:

- Two data entry people at the Print Shop can perform data-entry related functions and modify programs. These duties are incompatible and allow the opportunity to alter programs and billings.
- There is no off-site storage of backups for some of the Direct Billing System application files and master data files. The backup files are stored at the same location with the computer equipment. In addition, no formal document is stored off-site that contains all information necessary for locating key employees and data files.

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### **Recommendation No. 31:**

The Division of Central Services should ensure that there is:

- a. Proper segregation of duties and limited access to necessary functions by employees.
- b. Backups of application files and master data files are stored off-site in case of a disaster.

### **Division of Central Services Response:**

- a. Agree. Implemented June 30, 2001.
  - b. Agree. During the audit the recommendation was made to the Network Administrator that a monthly backup tape for the Condor Server be taken off-site. This process was implemented June 30, 2001.
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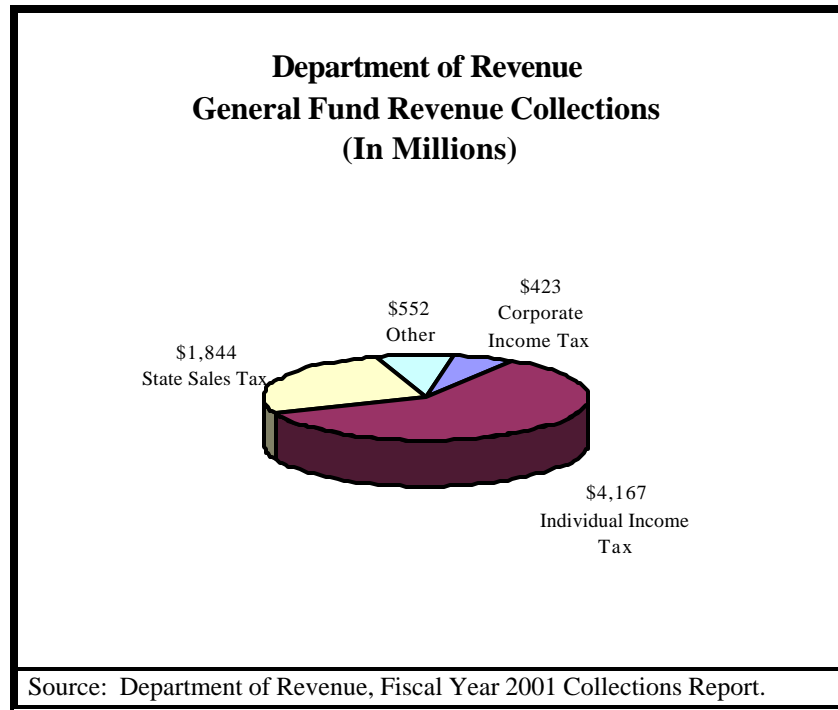
# Department of Revenue

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## Introduction

The Department of Revenue's primary role is to manage the State's tax system. Tax collections totaled \$8.7 billion in Fiscal Year 2001. In addition, the Department is responsible for performing various other functions as follows:

- C Administer the State Lottery, which grossed nearly \$351 million in ticket sales in Fiscal Year 2001. Of this amount, about \$79 million was available for distribution for capital construction as well as for parks and outdoor projects.
- C Act as a collection agent for city, county, RTD, special district, and severance taxes. The Department received nearly \$926 million in taxes and fees on behalf of other entities.
- C Collect taxes and fees for the Highway Users Tax Fund (HUTF), which is primarily for the benefit of highway maintenance projects in the State. In Fiscal Year 2001, amounts collected for the HUTF totaled approximately \$742 million.
- C Regulate the limited stakes gaming activities in Cripple Creek, Black Hawk, and Central City. The gaming communities grossed about \$651 million in Fiscal Year 2001.
- C Enforce tax, alcoholic beverage, motor vehicle, and emissions inspection laws.
- C Operate the State's 11 Ports of Entry.



In Fiscal Year 2001 the Department had a budget of nearly \$476 million and 1,523 full-time equivalent staff (FTE). The State Lottery Division had the largest share of the budget, accounting for nearly 65 percent of the total.

## TABOR Refund Mechanisms

The Taxpayer's Bill of Rights (TABOR) was added as Article X, Section 20, of the Colorado Constitution in the November 1992 general election. TABOR limits increases in the State's revenue to the annual inflation rate plus the percentage change in the State's population. Revenue in excess of this limitation must be refunded to taxpayers in the following fiscal year unless voters approve a revenue change that allows the State to keep the excess. TABOR also allows the State to use tax credits as a mechanism to refund the excess revenue.

For Fiscal Year 2001 there were nine mechanisms used to refund the \$941.1 million Fiscal Year 2000 TABOR excess. These included the state earned income credit; the personal property tax credit; the dividend, interest, and capital gains exemption; the capital gains modification; the rural health care provider credit; increased child care credits; the pollution control equipment credit; the health benefits plans credit; and the state sales tax refund.

We examined over 200 income tax returns from seven different samples, each relating to one of the nine TABOR refund mechanisms. During our testwork we found controls lacking over the issuance of some of these credits.

## Ensure Only Eligible Individuals Take TABOR Credits

Many of the credits require the submission of documentation in addition to the standard return that shows that a taxpayer is eligible to take the credit. Others restrict eligibility by the amount of a taxpayer's federal adjustable gross income. On the basis of our sample, we found that \$343,306 in credits were erroneously granted to ineligible taxpayers. Specifically, we found:

- **Over 600 taxpayers who were not appropriately certified by the Department of Public Health and Environment claimed the rural health care provider credit.** Individuals are statutorily required to be certified by the Department of Public Health and Environment (DPHE) to take the rural health care provider credit. Health care professionals who reside and practice in areas of Colorado that are understaffed can take a credit of up to one-third of the amount of qualified student loans. Out of 10 tax returns in our sample for this refunding mechanism, only one individual was certified by the DPHE and therefore qualified to take the credit. We compared a list of certified taxpayers with a report showing the total number that claimed the credit, and found that over 600 uncertified taxpayers took the credit for a total amount of \$309,250. Additionally, the certification form, which is required by statute, was missing in all 10 returns sampled. The Department does not have any controls in place to ensure only certified taxpayers claim this credit.
- **218 taxpayers erroneously claimed the earned income credit.** Taxpayers with a federal adjusted gross income of less than \$31,250 are eligible to take the state earned income credit. The credit is 10 percent of their federal earned income credit. In our sample of 60 tax returns, we found one individual with a federal adjusted gross income of greater than \$31,250 who had taken the credit. The Department provided us with a report showing an additional 217 taxpayers who had erroneously claimed the credit for a total amount of \$30,895.

- **At least seven ineligible taxpayers claimed the health benefit plan credit.** Individuals with a prior year federal adjusted gross income of less than \$35,000 are eligible to take the health benefit plan credit. The credit allows taxpayers to claim a credit for health benefit plans not paid for by an employer or deducted from federal adjusted gross income. We found 7 out of 25, or 28 percent, of taxpayers in our sample for this credit had federal adjusted gross income in excess of the threshold. The errors totaled \$3,161. The Department could not provide us with a report showing the prior year adjusted gross income of the individuals who took the credit. The Department basically has no controls to ensure the health benefit credit is appropriately taken.
- **40 returns did not include the Colorado Individual Credit Schedule or the Colorado Source Capital Gain Affidavit.** During our Fiscal Year 2000 audit, we found that taxpayers did not always submit the Colorado Individual Credit Schedule or the Colorado Source Capital Gain Affidavit. The schedule is required by the Department when claiming certain tax credits. The Department processed returns that were incomplete. For Fiscal Year 2001 we found that the schedule was not submitted in 25 out of 110 instances when required for the credits we sampled, and the affidavit was not submitted in 15 out of 25 instances in our sample of the Colorado Source Capital Gain Exclusion. The Department requires these forms but will process returns without them.

The Department does not have a methodology in place to verify taxpayers' federal adjusted gross income, and does not ensure that supporting documentation is submitted with the return. Such documentation is already required by statute or the Department's own instructions. Without this documentation, the Department cannot verify the eligibility of taxpayers to take the credits. Because there is no methodology in place to verify eligibility, individuals who were not eligible to take these credits, did so. The Department should identify and bill all individuals who ineligibly claimed these credits. If the schedules are not provided by the taxpayer, the Department should not process the return or should evaluate other methods of independently verifying the accuracy of the credit. Our audit clearly indicates the need for verification procedures.



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## **Recommendation No. 32:**

The Department of Revenue should ensure that only eligible individuals claim and receive TABOR credits by:

- a. Identifying and billing individuals that were ineligible to claim TABOR credits.
- b. Implementing a methodology to ensure that taxpayers are eligible for the credits taken.
- c. Processing only complete returns, or evaluating methods of ensuring that accurate credits are claimed should the taxpayer fail to submit the required schedules.

## **Department of Revenue Response:**

- a. Agree: The Department is currently in the process of identifying and billing any taxpayer that is found to have taken a credit in error. This process is part of our regular efforts to ensure accurate filings.

The Department does have edit criteria in place that result in the review of certain net capital gain deductions. If an affidavit was not filed, the Department requests the affidavit.

- b. Agree: However, the Department is concerned that the expenditure of resources on credits that might not exist for the next tax season is kept to a minimum. Further, the Department considers a number of factors in prioritizing its resources, including the number of taxpayers affected, the impact on processing returns, programming expense, anticipated results, and availability of other audit processes. The credits identified are fairly new and limited to a relatively few taxpayers and only select tax years. The following paragraphs describe actions being taken in response to the audit concerns:
  - Earned Income Credit. Implemented: The Department already has a computer edit in place to check income threshold.
  - Health Benefit Credit. The Department will investigate imposing a computer edit this year to audit for last year's federal adjusted gross income. We currently plan to audit this credit, as we explained in the fiscal note, as part of our Fair Share section's projects.

- Individual Credit Schedules and Net Capital Gain Affidavit. The Department must balance the need for efficient processing with the need for auditing and compliance efforts. The TABOR credits resulted in the requirement that new forms be attached to the return. Manual visual checking for the attachment of these forms would have significantly slowed the processing of the paper returns during the last tax season. The Department is under tremendous pressure to process over two million returns, many of which require refunds, in a short period of time, to avoid interest and refund penalties. All possible efforts to ensure compliance with the laws are being considered.
  - Rural Health Care Provider Credit. The Department will investigate a programming change to create a database to verify that the taxpayer has a certificate. Taxpayers without certification will be contacted for more information and, if appropriate, assessed.
- c. Agree. To the degree possible given limited resources. The above discussion describes the Department's activities in this regard.

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## **Enhance Controls Over Personal Property Tax Refund**

The personal property tax refund began as a TABOR refund mechanism in Fiscal Year 1999. This mechanism allows qualified taxpayers to claim a refund of personal property taxes paid to all taxing jurisdictions in Colorado. All qualified taxpayers were required to submit a paper return and proof of payment to claim the refund. The Department manually processed more than 100,000 property tax returns in Fiscal Year 1999. House Bill 00-1145 changed the process beginning in Fiscal Year 2000. The bill allows taxpayers to receive the refund automatically on the basis of information provided to the Department by county treasurers and county assessors. The counties are required to provide the Department with a personal property schedule number, the taxpayer's ID number, taxpayer's name and address, and the amount of personal property tax that was paid timely. During Fiscal Year 2001 about 104,000 refunds were issued, totaling \$84.6 million.

We found three problems during our review of the refund process. We found that (1) there are still more than 3,100 outstanding refund checks as of October 4, 2001, (2)

data entry errors were made by the Department, and (3) some counties are still unclear on the required information to be provided to the Department.

## **Resolve Outstanding Check Issues**

During our audit we found that some taxpayers were not receiving their refund checks. The Department did a mass mailing of refund checks in August 2000 for refunds of Calendar Year 1999 personal property taxes paid in Calendar Year 2000. Of the approximately 104,000 checks issued, there were more than 3,100 outstanding checks, totaling about \$1.3 million as of October 4, 2001. Among those checks, about 2,900 were issued on a single day, August 7, 2000, totaling \$1.1 million.

The outstanding checks ranged from \$1 to \$238,479, and most were cancelled as part of the State's expired check process. Although most were for \$25 or less, we found that there were 183 that were greater than \$500 each. The top 10 highest amounts ranged from \$6,177 to \$238,479 and appeared to belong to major corporations that are easily located. However, the Department had only contacted 3 of the taxpayers with the top 10 highest amounts and 17 of the 183 with outstanding checks over \$500, despite the checks having been issued over a year and a half before. We do not believe that the Department has made sufficient efforts to locate these taxpayers given the amount of time the checks have been outstanding.

We have asked the Department to immediately resolve this issue. The outstanding checks consist of (1) checks that have been mailed to taxpayers but were returned to the Department due to incorrect addresses or any other reasons, (2) checks that have been received by taxpayers but have not been cashed, (3) checks that have been issued but were not mailed to taxpayers until our audit. The Department was not able to provide us with a breakdown of the amounts for each of these categories.

It is imperative the Department attempt to locate the rightful owners of these outstanding checks. Since taxpayers are not required to submit paper returns, many may not be aware of the refunds owed to them. The Department could provide data regarding which taxpayers had outstanding checks to the county that originally provided information and work together to attempt to contact the individuals involved. Names of individuals with outstanding checks could also be posted on the Department's Web page, in order to provide a listing to interested parties. Alternatively, the Department should consider whether it is viable to turn the outstanding checks over to Treasury's Unclaimed Property section when other attempts to locate the taxpayers are exhausted.

### **Recommendation No. 33:**

The Department of Revenue should resolve outstanding check issues to ensure that taxpayers receive their personal property tax refunds in a timely manner.

#### **Department of Revenue Response:**

Agree: The Business Tax Accounting Section has, or will, contact the 183 taxpayers and attempt to re-issue these refunds.

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## **Verify the Accuracy of Data Entry**

Incorrect data entry can cause taxpayers to receive incorrect refunds. As part of our audit, we tested 60 refund records and found the following problems due to data entry errors. All the errors were corrected by the Department after we brought them to its attention.

- C Two instances in which complete information was provided by counties, but some details were omitted during data entry. This resulted in the taxpayers being underrefunded by \$866. The Department refunded the appropriate amounts to the taxpayers.
- C Four instances in which two or more different ID numbers were entered for the same taxpayer. In this case, the State overrefunded \$783. The taxpayers were billed for the amounts owed.
- C One instance in which the amount of the tax paid was entered incorrectly. This resulted in an overrefund of \$821. The taxpayer was billed for the amount owed.
- C One instance in which an invalid ID number was entered as a valid ID number. This resulted in an overrefund of \$32 by the State. The taxpayer was billed for the amount owed.

While these amounts are small, they are indicative of a basic lack of control over the personal property tax process.

We noted there were no edits or other verifying procedures in place during the data entry process for Fiscal Year 2001 refunds. Under House Bill 00-1145, counties can file their

reports electronically or in paper format. Beginning in Fiscal Year 2002, the Department plans to have a new reporting format for counties who will report the information in a paper format. There are edits in this new format to verify the accuracy of data entry for the amount of tax paid and the number of schedules submitted. However, there are no edits to ensure the accuracy of ID numbers or taxpayer addresses. The Department needs to obtain reasonable assurance that correct information has been obtained and used to process the refund.

The Department should continue to encourage counties to file their reports electronically and work cooperatively to reduce the submission of incorrect data. All the errors noted above were found in the reports filed in paper format. Approximately 39 percent of reports were filed electronically in Fiscal Year 2001. The Department also noted these manually processed reports were where the most data entry errors occurred.

## **Ensure Accuracy of Information**

During Fiscal Year 2001 the Department had to process more than 2,800 returned checks mainly because of incorrect address information provided by counties. The Department statutorily relies on information provided by each county treasurer and county assessor to process the refund. While some counties provided correct information to the Department, others did not. For example, some counties provided street addresses while the post office only delivered to P.O. boxes in some areas.

House Bill 01-1287 modified the administration of the credit. The bill requires each county to submit one set of combined information from the county treasurer and the county assessor. Prior to House Bill 01-1287 both the Treasurers had sent in separate reports on the same data. These reports sometimes contained inconsistent information. The Department also has provided counties with a new form to report necessary information. In the new form, there are specific instructions to ask for the ID number and mailing address, etc. In addition, the Department held meetings with county personnel to discuss the new procedures and requirements.

The accuracy of the information provided by counties is vital to the success of the property tax refund process. We contacted three of the largest counties in the State regarding the personal property tax refund. Representatives from two of the counties attended the meeting held by the Department and are aware of the new procedures and requirements. One county experienced many problems in Fiscal Year 2000 and is expecting the same problems again in Fiscal Year 2001.

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**Recommendation No. 34:**

The Department of Revenue should enhance personal property tax refund procedures by:

- a. Ensuring all the information furnished by the counties will be entered correctly and encouraging counties to file the report electronically.
- b. Providing additional training and assistance to counties so that they can provide more accurate required information.

**Department of Revenue Response:**

Implemented: All procedures surrounding personal property tax refunds were dramatically changed and improved prior to the November 2001 refunds.

- a. As of the October 1, 2001 deadline, 86 percent of all counties had filed electronically.
  - b. Since the November 2001 refunds were issued, only one county submitted incomplete information.
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# Office of the State Treasurer

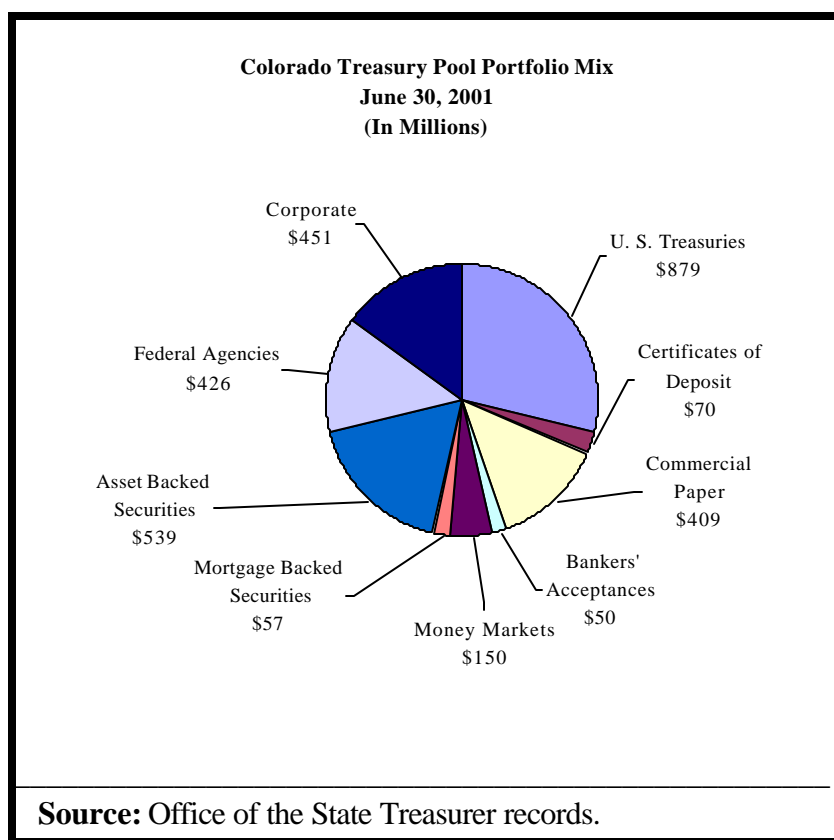
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## Introduction

The Office of the State Treasurer is established by the State Constitution. The Treasurer is an elected official who serves a four-year term. The Office manages the State's investments, and implements and monitors the State's cash management procedures. Other duties and responsibilities include:

- Receiving, managing, and disbursing the State's cash.
- Safekeeping the State's securities and certificates of deposit.
- Managing the State's Unclaimed Property Program, the School District Loan Program, and the Elderly Property-Tax Deferral Program.

The State's pooled investments are made up of a variety of securities as shown in the following chart:



## Ensure Custodial Funds Receive Interest

The Treasurer's Office held over \$190 million in cash on behalf of others in Fiscal Year 2001. This amount is recorded in about 70 custodial funds on the State's accounting system. The funds range from sales taxes collected by the Department of Revenue for cities and counties to collateral received by the Oil and Gas Conservation Commission from operators to conduct oil and gas operations. The amounts recorded in the custodial funds are deposited as part of the Treasury's pooled cash, and interest is earned on the deposits. Since the Treasurer's Office acts as the custodian of the monies, the interest earned should not be credited to the State. Instead, the interest belongs to the entities. During our testing we noted that the Treasurer's Office was not crediting interest received to the custodial funds as required.

In Fiscal Year 1991 the Treasurer's Office obtained an Attorney General's opinion regarding the payment of interest to custodial funds. The opinion specifically stated that interest earned on a custodial fund is to be credited to that custodial fund. During Fiscal Year 2001 we noted that about 30 custodial funds received the interest due, while the interest for the remaining approximately 40 funds was credited to the State's General Fund. We estimated that the General Fund received about \$2.2 million in interest that should have been credited to custodial funds in Fiscal Years 2000 and 2001. The majority of this amount related to sales and severance taxes collected on behalf of cities and counties at the Department of Revenue. Therefore, the interest should have been paid to these cities and counties.

In the past the Treasurer's Office has credited interest to custodial funds only after a request from another state agency. This was because the Office had no definitive way to determine whether the funds were actually custodial in nature and should be receiving the interest. We believe that since the Attorney General's opinion was addressed to the Treasurer's Office, it is the Office's responsibility to ensure that custodial funds are receiving interest. Therefore, the Treasurer's Office should work with state agencies to identify which custodial funds are not currently receiving interest and ensure that such funds receive the proper amount due them.

In addition, the amount of interest recorded in the State's accounting system can have an impact on TABOR revenue. The source of the interest received determines whether interest revenue should be included in or excluded from the TABOR base. Interest credited to the State's General Fund is included as TABOR revenue. We have brought this to the attention of the Treasury's staff who are in the process of identifying which funds should have received interest and the amount. This process will be completed by June 30,



2002, and the impact on TABOR and agency funds will be assessed at that time. Therefore, the State Treasurer's Office should determine the amount of interest that should have been paid to the custodial funds in the past three fiscal years and the TABOR effect, if any.

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### **Recommendation No. 35:**

The Treasurer's Office should ensure that all custodial funds receive the proper amount of interest due by:

- a. Working with state agencies to identify the custodial funds that should receive interest.
- b. Determining how much interest should have been paid to custodial funds instead of the State's General Fund for the past three fiscal years.
- c. Determining the TABOR effect, if any, on the interest recorded in the State's General Fund instead of the custodial funds.

### **Treasurer's Office Response:**

Agree. The Treasurer agrees with the requirement to pay interest on those accounts that are custodial. The Treasurer also agrees that the Treasurer is the appropriate authority to determine which accounts are or are not custodial.

Section 24-36-114, C.R.S., gives the Treasury the fiduciary and statutory responsibility to credit all interest earnings on "state money" to the General Fund unless expressly directed otherwise. This obliges the Treasurer to operate upon the presumption that interest earnings from any funds on deposit in the Treasury are credited to the General Fund unless he receives statutory direction or appropriate documentation that allows him to make a determination that the fund is custodial. Therefore as a matter of policy, the agency or department that opens the account must provide the Treasurer the information he needs to determine that the account is custodial. Without that documentation, he will presume the account is not custodial and continue to credit the interest to the General Fund.

Over the past several months, the Treasurer has repeatedly asked the other departments to update their lists of custodial accounts and to provide the documentation to support that list. Included in these requests was a detailed description from the Attorney General's opinion explaining the nature of custodial

funds. Unfortunately, to date, the Treasurer has received a minimal response from the other departments to these letters. Significantly, of the few responses the Treasurer has received, the majority were for accounts that the Treasurer determined were not custodial.

The Treasurer will send another request that the agencies and departments update their lists of current custodial accounts by March 31, 2002. When the Treasurer receives information from the agencies and the departments, he shall complete steps b. and c. of the recommendation.

To ensure the proper recording of interest, the Treasurer will request updated information from agencies on an annual basis.

Implementation date: June 30, 2002

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## **Compliance With Colorado Funds Management Act**

The Colorado Funds Management Act (the Act), (Section 24-75-901, C.R.S.), was enacted to allow the State to finance temporary cash flow deficits caused by fluctuations in revenue and expenditures. Under the Act, the State Treasurer is authorized to sell Tax and Revenue Anticipation Notes (TRANS). TRANS are short-term notes payable from the future anticipated pledged revenue.

The Office of the State Auditor reviews information relating to tax and revenue anticipation notes and reports this information to the General Assembly as directed by Section 24-75-914, C.R.S. This report section provides information about the July 3, 2001, issuance of \$150 million in General Fund Tax and Revenue Anticipation Notes (hereafter referred to as the Series 2001A Notes) and the October 12, 2001, issuance of \$600 million in General Fund Tax and Revenue Anticipation Notes (hereafter referred to as the Series 2001B Notes).

### **Terms and Price**

Both series of Notes have a maturity date of June 28, 2002, and are not subject to redemption prior to maturity. This date complies with the Act, which requires the maturity date to be at least three days prior to the end of the fiscal year of issue. The table on the following page provides other details of the terms and price.

State of Colorado Details of Series 2001A and 2001B Note Issues		
Issue Amount:	2001A	\$150,000,000
	2001B	\$600,000,000
Denomination (Both Series)		\$5,000
Premium on Sale:	2001A	\$2,043,600
	2001B	\$3,723,300
Face Interest Rate:	2001A	3.50%
		4.00%
	2001B	3.00%
		3.25%
Average Interest Cost to the State:	2001A	2.551%
	2001B	2.144%
<b>Source:</b> Office of the State Treasurer records.		

Notes in each series are issued at different face interest rates. These are the rates at which interest will be paid on the Notes. The average interest cost to the State differs from the face amount because the Notes are sold at a premium, which reduces the interest expense incurred.

## Security and Source of Payment

In accordance with the Act, principal and interest on the Series 2001A and 2001B Notes are payable solely from any cash income or other cash receipts recorded in the General Fund for Fiscal Year 2002. General Fund cash receipts include those that are subject to appropriation in Fiscal Year 2002 and any pledged revenue, including the following:

- Revenue not yet recorded in the General Fund at the date the Notes were issued.
- Any unexpended Note proceeds.
- Proceeds of internal borrowing from other state funds recorded in the General Fund.

The State Controller will record monies reserved to pay the principal and interest of the Notes in the Series 2001 Note Payment Account (Account). The holders of the Notes are secured by an exclusive first lien on assets in the account. The State Treasurer holds, in custody, the assets in the Series 2001 Note Account.

If the balance in the Account on June 15, 2002, is less than the principal and interest of the Notes due at maturity, the Treasurer must deposit into it all General Fund revenue then available and borrow from other state funds until the balance meets the required level.

The amount due at maturity for Series 2001A is \$155,818,056, consisting of the Note principal of \$150,000,000 and interest of \$5,818,056. The amount due at maturity for Series 2001B is \$612,871,111, consisting of the Note principal of 600,000,000 and interest of \$12,871,111. To ensure the payment of the Series 2001A and 2001B Notes, the Treasurer has agreed to deposit pledged revenue into the Account so that the balance on June 15, 2002, will be no less than the amount to be repaid. The Note agreement also provides remedies for holders of the Notes in the event of default.

## **Legal Opinion**

Kutak Rock LLP, bond counsel, have stated that, in their opinion:

- The State has the power to issue the Notes and carry out the provisions of the Note agreements.
- The Series 2001A and 2001B Notes are legal, binding, secured obligations of the State.
- Interest on the Notes is exempt from taxation by the United States government and by the State of Colorado.

## **Investments**

Both the Colorado Funds Management Act and the Series 2001A and Series 2001B Note agreements allow the Treasurer to invest the funds in the Account in eligible investments until they are needed for Note repayment. Interest amounts earned on the investments are credited back to the Account. The State Treasurer is authorized to invest the funds in a variety of long-term and short-term securities according to Article 36 of Title 24, C.R.S. Further, Section 24-75-910, C.R.S., of the Funds Management Act states that the Treasurer may:

- Invest the proceeds of the Notes in any securities that are legal investments for the fund from which the Notes are payable.
- Deposit the proceeds in any eligible public depository.

## **Purpose of the Issue and Use of Proceeds**

The Notes are being issued to fund the State's anticipated General Fund cash flow shortfalls during the fiscal year ending June 30, 2002. The proceeds of the sale of the Notes were deposited in the State's General Fund. Note proceeds will be used to alleviate temporary cash flow shortfalls and to finance the State's daily operations in anticipation of taxes and other revenue to be received later in Fiscal Year 2002.

## **Additional Information**

The Notes were issued through a competitive sale. A competitive sale involves a bid process in which notes are sold to bidders offering the lowest interest rate.

The Notes issuance is subject to the Internal Revenue Service's (IRS) arbitrage requirements. In general, arbitrage is defined as the difference between the interest earned by investing the Note proceeds and the interest paid on the borrowing. In addition, if the State meets the IRS safe harbor rules, the State is allowed to earn and keep this arbitrage amount. The Department of Treasury is responsible for monitoring compliance with the arbitrage requirements to ensure that the State will not be liable for an arbitrage rebate.

## **State Expenses**

There are expenses incurred by the State that are directly associated with the issuance and redemption of the TRANS. These expenses include:

- Bond legal counsel fees and reimbursement of related expenses incurred by the bond counsel.
- Disclosure counsel fees and expenses.
- Fees paid to rating agencies for services.
- Costs of printing and distributing preliminary and final offering statements and the actual notes.

- Travel costs of state employees associated with note issuance and selection of a financial advisor.
- Redemption costs, consisting of fees and costs paid to agents to destroy the redeemed securities.

The above expenses were approximately \$122,000 for the Series 2001A and Series 2001B Notes.

No recommendation is made in this area.

# Department of Transportation

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## Introduction

The Colorado Department of Transportation is responsible for programs that impact all modes of transportation. The State Transportation Commission governs its operations.

In Fiscal Year 2001 about 78 percent of the Department's expenditures were related to construction funded by the Federal Highway Administration (FHWA) and state sales and use tax funds. The Department's portion of the State Highway Users Tax Fund (i.e., the State Highway Fund) and various aviation-related taxes fund most of its other expenditures. The Department also receives monies from other federal agencies that it passes through to local governments and other entities for highway safety and transportation improvement programs.

The FHWA funds are used for research, planning, and construction of highways. The State Highway Fund and Bond Revenues pay for highway maintenance and operations and about 65 percent of any highway construction not covered by FHWA funds.

The following comments were prepared by the public accounting firm of Arthur Andersen LLP, who performed audit work at the Department of Transportation.

## Perform Monthly Reconciliation of Note Proceeds Accounts

During Fiscal Years 2000 and 2001 the Department issued Transportation Revenue Anticipation Notes. The proceeds from the issuance of the Notes are maintained in three bank accounts, which in aggregate totaled about \$1.03 billion at year-end.

We found that the Department does not reconcile between the bank statements and the general ledger on a monthly basis. Failure to reconcile bank accounts monthly increases the risk that transactions recorded by the bank (e.g., interest and dividends) are not recorded in the general ledger, or vice versa, leading to a misstatement of cash balances. We noted that the Department did not record about \$172,000 of dividends earned as of year-end.

Monthly reconciliations would have detected this difference and facilitated the recording of the dividend income in a timely manner. An individual should be assigned and trained. A standard template should be developed to simplify completion of the monthly reconciliation.

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### **Recommendation No. 36:**

The Department of Transportation should:

- a. Create a standard template for use in completing reconciliations of the Note proceeds bank accounts.
- b. Assign one individual to perform the reconciliations for the Note proceeds accounts.
- c. Provide adequate training for the assigned individual so that the proper reconciliation procedures are fully understood.

### **Department of Transportation Response:**

Agree. Bank reconciliations will be assigned to an individual and these reconciliations will be accomplished on a monthly basis.

Implement December 31, 2001.

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## **Ensure Leases Are Properly Classified and Future Payments Are Correctly Reported**

The Department leases equipment for use in its operations, such as copiers and other office equipment. As of year-end, the Department has entered into leases that will require aggregate future payments of about \$2.7 million. During our audit we found two problems with the recording and accounting for leases, as follows:

**The Department does not have formal policies or procedures in place to evaluate the classification of leases.** The Department currently classifies all new leases as operating leases. This treatment may not be correct.



There are two types of leases, capital and operating. Capital leases consist of items such as equipment that is essentially considered as being owned. The equipment is recorded as an asset of the Department and the debt is recorded as a liability. The principal portion of future payments is offset against the liability, and only the interest portion is recorded as an expense on the statement of operations. In contrast, operating leases do not give rise to property rights or obligations. As such, all payments related to operating leases are recorded as lease expense.

While we did not find any leases that were classified incorrectly, a formal process should be put in place to evaluate the classification of all leases. Certain individuals should be assigned the responsibility for reviewing leases. Accounting standards contain the authoritative criteria for capital versus operating leases and should be incorporated into a checklist to aid in the classification. Failure to perform such an evaluation may result in classifying capital leases as operating, causing a misstatement of the related assets, obligations, and expenses.

**The Department is not properly compiling the required information of future lease payments.** For operating leases, financial accounting standards require disclosure of the future lease payments that will be due within each of the five years following the balance sheet date, and the aggregate amount thereafter. We noted errors in the Department's compilation of this information. The Department calculates future minimum lease payments from a summary schedule prepared from the Department's records. Errors that were noted included expired and cancelled leases on the summary schedule, and certain leases on the schedule multiple times. We tested 13 leases related to the future minimum lease disclosure and found an overstatement of future lease payments of about \$68,000.

These errors resulted from a lack of formal procedures that provide for adequate oversight by the accounting department in obtaining information from other divisions of changes in the payment amount and lease terms and a lack of controls in the compilation of the summary schedule. Errors in the preparation of the summary lease schedule may result in over- or understatement in the disclosure of future obligations under operating leases.

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## **Recommendation No. 37:**

The Department of Transportation should:

- a. Ensure that leases are properly classified as operating or capital. A checklist should be developed that lists out the criteria for capital lease accounting. This checklist should be completed at the initiation of every new lease. Assign the

responsibility of lease evaluation to certain employees and provide training on capital lease criteria.

- b. Evaluate the completeness and accuracy of the operating lease summary schedule used to compile the future minimum lease disclosure.
- c. Review the operating lease summary schedule for accuracy at year-end. This review should include verification with the responsible party that the reported leases exist and that the terms are accurate. The review should also include a confirmation that each lease is only included on the schedule once and that all new lease agreements are included.

### **Department of Transportation Response:**

Agree. Due to funding constraints, the Department does not typically enter into capital leases. However, since the possibility exists to inadvertently execute a capital lease, a checklist will be developed to ensure the timely and accurate reporting of all leases. Implement June 30, 2002.

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